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Inland Revenue
Te Tari Taake

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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

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IN SUMMARY

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New Zealand signed the MLI on 7 June 2017, and deposited its instrument of ratification with the MLI Depositary on 27 June 2018.

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During Public Consultation on QB 18/14: *GST treatment of fees that suppliers charge customers for using a credit or debit card* the Commissioner signalled that she would be re-issuing IS 17/03: *Single supply or multiple supplies*. The Commissioner was aware that some taxpayers had read example 4 of IS 17/03 as suggesting that a credit card surcharge would always be a separate exempt supply of financial services. This is not the Commissioner's position. IS 17/03 has therefore been re-issued as IS 18/04 to clarify that the provision of a payment facility will not always be an exempt supply of a financial service.

IS 18/05: Income tax - donee organisations – meaning of wholly or mainly applying funds to specified purposes in New Zealand 25

This interpretation statement concerns donee organisations under s LD 3(2)(a) of the Income Tax Act 2007. It is relevant to organisations applying funds to purposes within New Zealand **and** to purposes overseas. It is not relevant to organisations listed in schedule 32 of the Act. The statement clarifies the interpretation of the requirement for a donee organisation to apply its funds "wholly or mainly" to charitable, benevolent, philanthropic, or cultural purposes within New Zealand. The statement also explains Inland Revenue's "safe harbour" approach to administering this requirement. Inland Revenue will generally accept without further enquiry that an organisation meeting the minimum safe harbour percentage of 75% has met the requirement. The statement is accompanied by a fact sheet that sets out the most important information from the statement and repeats the examples. You can find the fact sheet at **www.ird.govt.nz**, technical tax area (keyword: IS 18/05 fact sheet).

Legal decisions - case notes

Application for restoration to the Register of Companies 76

The applicants sought orders to restore five companies to Register of Companies ("the Register"). The Court considered that on balance, the private and public interests favoured restoration of the relevant companies to the Register.

Application to extend time for SOP dismissed 77

Two companies were in dispute with the Commissioner of Inland Revenue ("the Commissioner") concerning GST input credits and had two months to issue Statements of Position ("SOPs") in response to the Commissioner's SOPs. Vicente Lopez, the sole director and shareholder of both companies, applied in his own name to extend time for the companies to issue their SOPs. The Commissioner successfully applied to dismiss Mr Lopez's application, both for lack of jurisdiction (the companies should have applied, not Mr Lopez) and, even if the companies had made the application, it would not have succeeded as the grounds in s 89M(11) of the Tax Administration Act 1994 for an extension of time were not met.

An application for orders appointing a replacement liquidator 79

The Commissioner of Inland Revenue ("the Commissioner") applied for orders appointing a replacement liquidator for Mercantile Developments Limited by way of originating application without notice. The Court agreed that the Commissioner had standing as a prospective creditor to bring the application and that it was in the public interest that an experienced liquidator be appointed.

High Court confirms deductions for bad debts not available as operating a "Benevolence on the Conscience Loan Fund" not a money lending business 79

Unsuccessful taxpayer appeal of a decision in the Taxation Review Authority. The High Court confirmed the Commissioner of Inland Revenue's assessments disallowing two deductions for bad debts under s DB 31 of the Income Tax Act 2007 and imposing shortfall penalties under s 141A for not taking reasonable care. The appellant was found not to carry on a business of holding financial arrangements, nor had he discharged the onus of proving that he wrote the debts off as bad in the 2011 income year.

GENERAL ARTICLES

New Zealand's ratification of the OECD's *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*

The Organisation for Economic Cooperation and Development's (OECD) *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* ("the Multilateral Instrument" or "the MLI") is a multilateral international treaty designed to quickly and efficiently incorporate new model treaty provisions arising out of the G20/OECD *Base Erosion and Profit Shifting* (BEPS) work into existing tax treaties.

New Zealand signed the MLI on 7 June 2017, and deposited its instrument of ratification with the MLI Depositary on 27 June 2018. In accordance with Article 34(2) of the MLI, the MLI entered into force for New Zealand on 1 October 2018. It is expected that the MLI will apply to the majority of New Zealand's bilateral tax treaties, or double tax agreements (DTAs). However, this will occur on a progressive basis, depending on when New Zealand's treaty partners ratify the MLI.

The provisions being incorporated into New Zealand's DTAs through the MLI have been designed to help prevent the misuse and abuse of tax treaties for tax avoidance and tax minimisation purposes, while also ensuring that such rules do not lead to unnecessary uncertainty for compliant taxpayers, or unintended double taxation.

Background

The G20/OECD BEPS project was an international initiative launched in 2013 with the development of a 15-point Action Plan to respond to mounting concerns that multinational enterprises are able to derive significant worldwide profits and appear to pay little or no tax anywhere in the world on those profits. The BEPS project sought to identify the particular structures and mechanisms that multinational enterprises use to escape appropriate taxation on the profits they derive with the aim of achieving international consensus on a range of effective solutions. The final reports for the Action Plan items were published in 2015.

A number of the items on the BEPS Action Plan address the misuse of DTAs and can only be implemented through changes to DTAs themselves. Some of these solutions are "minimum standards" that countries that commit to solving BEPS are expected to adopt. Other provisions are optional, but are DTA "best practice" and now form part of the OECD Model Tax Convention.

The new provisions cover a broad range of areas with the overall aim of preventing the misuse or abuse of treaties without giving rise to unnecessary uncertainty for taxpayers or unintended double taxation, specifically:

- preventing the granting of treaty benefits in inappropriate circumstances (Action 6);
- preventing the artificial avoidance of permanent establishment status (Action 7);
- neutralising the effects of hybrid mismatch arrangements that have a treaty aspect (Action 2); and
- providing improved mechanisms for effective dispute resolution (Action 14).

Given the important role the OECD Model Tax Convention plays in informing New Zealand's tax treaty policy, as well as New Zealand's commitment to resolving BEPS more generally, New Zealand is committed to including these minimum standards as well as the optional best practice provisions in its DTAs, where they are in line with overall New Zealand treaty policy.

The new model treaty provisions will generally be included in tax treaties as they are negotiated or updated. However, updating an entire network of tax treaties would take years as it would require bilateral negotiations which are both costly and time consuming, so the MLI was developed as a tool to simultaneously update existing tax treaties around the world and was formally adopted by the OECD in November 2016.

Signing the MLI is optional and only the "minimum standard" provisions are mandatory. Such optionality means that not all of New Zealand's 40 existing DTAs will be modified by the MLI. Those that will be modified will not necessarily all be modified in the same way or at the same time.

Key features

Broadly, where both parties to a particular DTA sign the MLI and make the appropriate notification that the MLI is to apply to that DTA, the DTA will constitute a 'Covered Tax Agreement' and will be modified by the MLI without any need for bilateral negotiations.

The extent to which the Covered Tax Agreement is then modified depends upon the options chosen by each DTA partner. The MLI provisions that represent BEPS minimum standards will always apply, but the MLI provisions which correspond with the BEPS best practice provisions are optional and will only apply when there is a match in the choices made by each respective DTA partner.

These choices are made by making formal notifications and reservations under Articles 28 and 29 of the MLI at the time the instrument of ratification is deposited with the OECD. The OECD, as the MLI Depositary, maintains a "master" list of all signatures, ratifications, notifications and reservations on its website (**www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf**). Commentary on the application of the MLI has also been published by the OECD, in the form of an explanatory statement.

Covered Tax Agreements

In its notifications and reservations made at the time New Zealand's instrument of ratification was deposited, New Zealand listed 37 of its 40 DTAs, representing all those DTA partners that had also indicated interest in signing the MLI. Those that had not indicated such interest, and which were therefore excluded from New Zealand's list, were Samoa, Taiwan and the United States of America.

As of July 2018, 33 of the 37 DTA partners listed by New Zealand had signed the MLI, but only 30 of those had also listed New Zealand. In addition, only three of those DTA partners had ratified the MLI (Poland, Sweden and the United Kingdom) as of July 2018. It may take some time before it becomes clear which of New Zealand's DTAs will actually be covered by the MLI.

Where possible, those of New Zealand's DTAs that are not ultimately covered by the MLI will be amended to include the BEPS provisions by means of bilateral negotiations. In this regard, three DTA partners that have signed the MLI have not listed New Zealand (Austria, Norway and Switzerland) on the basis that they are anticipating bilateral negotiations for other reasons.

Minimum standards

A number of the BEPS model provisions represent minimum standards. That is, they are effectively mandatory, and adherence to the minimum standards will be subject to international peer review. The minimum standards are:

1. The preamble of the DTA must include a clarification confirming that the DTA is not intended to provide opportunities for tax avoidance or double non taxation (Article 6 of the MLI).
2. The DTA must include an anti-abuse provision to ensure that treaty benefits are not granted under the DTA in inappropriate circumstances (Article 7 of the MLI).
3. The dispute resolution mechanism that features in all DTAs (referred to as the 'Mutual Agreement Procedure', or 'MAP') must ensure that jurisdictions resolve treaty-related disputes in a timely, effective and efficient manner (Article 16 of the MLI).
4. The rule for associated enterprises must ensure that appropriate transfer pricing adjustments made in one jurisdiction are matched by corresponding adjustments in the other jurisdiction (Article 17 of the MLI).

In some cases, the MLI provides flexibility in the way that a jurisdiction can choose to meet the minimum standards. For example, the minimum period for invoking a MAP case can be set through domestic legislation rather than in each DTA. Article 7 also provides optionality for meeting the anti-abuse provision minimum standard. Under Article 7, New Zealand has selected the Article 7(4) option of adding a principal purpose test to its DTAs. The principal purpose test is a general anti-abuse rule that applies to the whole DTA.

Optional provisions

Through the notifications and reservations made at the time the instrument of ratification was deposited with the OECD (**www.oecd.org/tax/treaties/beps-mli-position-new-zealand-instrument-deposit.pdf**), New Zealand chose to adopt the optional (or "best practice") provisions in its DTAs that will address:

1. **Neutralising the effects of hybrid mismatch arrangements**. New Zealand has opted for the optional provisions dealing with fiscally transparent entities (Article 3) and dual resident entities (Article 4).
2. **Preventing the granting of treaty benefits in inappropriate circumstances**. In addition to the minimum standards referred to above (the preamble and anti-abuse rule in Articles 6 and 7), New Zealand has opted for the optional provisions that establish a holding period requirement for claiming the reduced DTA withholding tax rates on dividends (Article 8), that strengthen (and/or insert) provisions that allow a jurisdiction to tax gains from selling shares in 'land rich' companies (Article 9), that insert an anti abuse provision for third State permanent establishments ('PEs') (Article 10), and that preserve a jurisdiction's right to tax its own residents (Article 11).

3. **Preventing the artificial avoidance of PE status.** New Zealand has opted for the optional provisions that insert an anti-avoidance rule for commissionaire arrangements (Article 12), a rule qualifying the specific activity exemption from the PE definition and an associated anti fragmentation rule (Article 13), and an anti contract splitting rule (Article 14).
4. **Making dispute resolution mechanisms more effective.** In addition to the minimum standards referred to above (relating to MAP cases and corresponding adjustments), New Zealand has opted for the optional provision that allows a taxpayer to apply for mandatory binding arbitration if the tax authorities have not been able to resolve a case under the MAP (Part VI of the MLI).

Even though New Zealand has opted for the above optional provisions, any particular DTA will only be modified by the MLI if it is a covered tax agreement and to the extent that the DTA partner has chosen the same options.

The OECD has developed a matching tool to enable users to determine how the MLI will update a particular DTA. This tool is available on the OECD website (**www.oecd.org/tax/treaties/mli matching database.htm**).

Guidance on the date of effect and the extent of modification for each DTA will be publicised on Inland Revenue's tax policy website as the relevant jurisdictions ratify the MLI (**taxpolicy.ird.govt.nz/tax treaties**).

Official information regarding the MLI as published by the OECD, including positions taken by jurisdictions and relevant dates, is available at:

www.oecd.org/tax/treaties/multilateral convention to implement tax treaty related measures to prevent beps.htm

Application dates

The MLI entered into force for New Zealand on 1 October 2018.

The MLI will have effect under Article 35(1) for New Zealand's DTAs on a staggered basis depending on the timing of ratification by each respective treaty partner. Generally, the MLI will apply to a DTA, from the latest of the dates on which the MLI enters into force for New Zealand and the other jurisdiction:

(i) with respect to withholding taxes from 1 January of the following calendar year; and

(ii) with respect to all other taxes for taxable periods commencing on or after the expiry of six calendar months.

INTERPRETATION STATEMENTS

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

IS 18/04: Goods and services tax – single supply or multiple supplies

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated. Relevant legislative provisions are reproduced in the appendix to this Interpretation Statement.

Summary

1. This Interpretation Statement updates and replaces “IS 17/03: Goods and services tax - Single supply or multiple supplies” *Tax Information Bulletin* Vol 29, No 4 (May 2017): 102.

2. A registered person who enters into a contract with a recipient to supply several goods and services needs to determine what sort of supply or supplies they have made so they can correctly account for GST. Where multiple elements are supplied with potentially different GST treatments, the supplier must determine whether they have made a single composite supply (of all the elements) with a single GST treatment, or multiple separate supplies (of each element or a combination of elements) with different GST treatments.

3. In some cases, it may be clear from the contract that only a single element is supplied to the recipient. Boundary issues do not arise on the supply of a single element.

4. Boundary issues may arise where multiple elements are supplied together. Boundary issues arise where some elements of the supply are subject to GST at the standard rate and other elements are zero-rated, exempt or not subject to GST at all. If the GST treatment of each element of the supply is the same then boundary issues do not arise.

5. Sometimes the Act deems supplies of multiple elements to be treated in a particular manner (for example, ss 5(20B), 5(20) and 5(15)). Where the Act does not deem a particular outcome, the arrangement actually entered into and carried out between the supplier and recipient must be carefully considered. The answers to the following questions may help a registered person to decide whether they have made one composite supply or multiple separate supplies:
   - What is the true and substantial nature of what is supplied to the recipient for their payment?
   - What are the relationships between the elements supplied?
   - Is it reasonable to sever the elements into separate supplies?

6. The first question requires a registered person to identify the true and substantial nature of what is supplied to the recipient. This is determined objectively and examines what is supplied ***from the recipient’s perspective***.

7. The fact elements supplied to the recipient could have been supplied separately does not mean those elements should be severed from the rest of the supply. In addition, the fact a single price is charged to the recipient does not determine whether one or more than one supply is made. It is the actual supply made to the recipient that must be considered and not how the supply is invoiced or charged to the recipient.

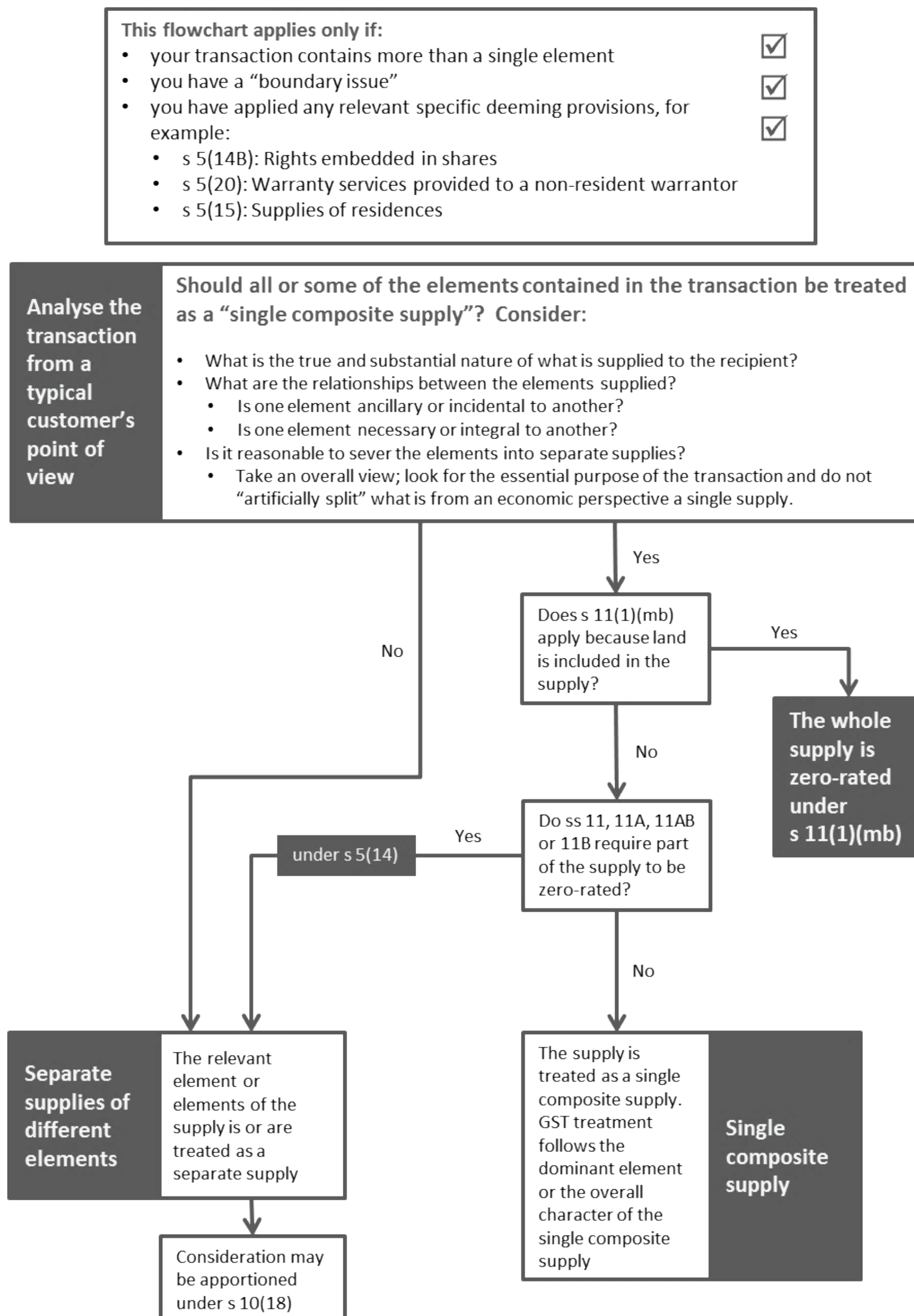
8. In considering the second question, namely the relationships between the different elements supplied, the courts consider whether one element is merely ancillary or incidental to, or a necessary or integral part of, any other element of the transaction. The phrases “ancillary or incidental to” and “necessary or integral part of” are different descriptions of a similar test. The facts of each case will determine which description is more appropriate. Factors that indicate that elements are ancillary or incidental to, or a necessary or integral part of, a dominant element include whether the element is:
   - not an aim in itself; instead, the element facilitates, contributes to, or enables the supply of the dominant element;
   - a means of better enjoying the dominant element;
   - an optional extra and is not in any real or substantial sense part of the consideration for which a payment is made.

9. The third question to answer is whether a sufficient distinction exists between the different elements of a transaction to make it reasonable to sever them into separate supplies. This question requires taking an overall view and looking for the essential purpose of the transaction and not artificially splitting what, from an economic point of view, is a single supply. If, on an objective assessment, it is not reasonable to sever the different elements of the transaction, then there will be only one composite supply.

10. If there is one composite supply, the zero-rating provisions may apply to zero-rate part or all of the supply. The compulsory zero-rating of land provisions may mean the supply is zero-rated if it includes land: s 11(1)(mb). Additionally, despite being a single composite supply, part of the supply may be required to be zero-rated: ss 11, 11A, 11AB or 11B. If the zero-rating provisions do not apply, the GST treatment will follow the dominant element of the supply. If there is no dominant element (for example, the supply is made up of several equally important elements that are integral to each other), the GST treatment will be determined by the overall characteristics of the single composite supply.

11. If there are multiple supplies, the relevant provisions of the Act are applied to each supply. Where the recipient pays a global amount for multiple supplies with different GST treatments, the consideration is apportioned under s 10(18) between taxable supplies and non-taxable or exempt supplies.

12. The process is summarised in the following flowchart. The flowchart is intended to be an aid to interpretation only. A more detailed discussion of the process follows the flowchart:



Introduction

13. GST is imposed on the supply of goods and services in the course or furtherance of a taxable activity carried on by a registered person by reference to the value of the supply: s 8(1). Supply is defined broadly to include "all forms of supply": s 5(1). Supplies can be subject to GST at the standard rate, or be zero-rated, exempt or not subject to GST. Issues can arise where different elements of a supply are potentially subject to different GST treatments. These issues are referred to as "boundary issues".
14. Boundary issues arise only where multiple elements are supplied. Contracts for the supply of a single element do not raise boundary issues. Boundary issues primarily arise where some elements of the supply are subject to GST at the standard rate and other elements are zero-rated, exempt or not subject to GST. If the GST treatment of each element of the supply is the same, then boundary issues do not arise. Unlike other jurisdictions, New Zealand has relatively few boundary issues.
15. Where multiple elements are supplied with potentially different GST treatments, the supplier must determine whether they have made a single composite supply with a single GST treatment or multiple separate supplies with different GST treatments.
16. The single composite supply or multiple separate supplies issue arises in various scenarios. For example:
    - language schools – whether the supply of language tuition (standard-rated) is a separate supply from pre-arrival assistance services (zero-rated), which was considered in *Auckland Institute of Studies Ltd v CIR* (2002) 20 NZTC 17,685 (HC) and is discussed from [42];
    - credit card surcharges – whether the charge for paying by credit card (exempt) can be separated from the goods or services being paid for (standard-rated); and
    - loyalty cards – whether the supply of loyalty points (standard-rated) is a separate supply from the supply of credit card services (exempt).
17. The Commissioner considered specific single composite supply or multiple separate supplies issues in the following items:
    - "Financial Planning Fees – GST Treatment" *Tax Information Bulletin* Vol 13, No 7 (July 2001): 37 (IS0079). This statement addresses the GST treatment of financial planning fees charged to investors where the supply comprised exempt financial services and associated potentially standard-rated services.
    - "QB 12/07: Goods and Services Tax – Treatment of Transitional Services Supplied as Part of the Sale of a Business (that Includes the Supply of Land)" *Tax Information Bulletin* Vol 24, No 6 (July 2012): 65.
    - "Goods and Services Tax – GST and Retirement Villages" *Tax Information Bulletin* Vol 27, No 11 (December 2015): 6 (IS 15/02). This statement addresses the GST treatment of taxable supplies of care services and accommodation in a commercial dwelling, and exempt supplies of financial services and accommodation in a non-commercial dwelling.
18. The purpose of this Interpretation Statement is to set out the general principles for determining whether a supply of multiple elements (supplied together in a single transaction) is a single composite supply or multiple separate supplies and to apply those principles to examples. The Commissioner considers that these general principles are consistent with those set out and applied in the items listed at [17].

Analysing supplies involving boundary issues

19. Before reviewing how the courts have analysed boundary issues, it is necessary to consider whether any specific deeming provisions of the Act will apply.
20. The Act contains several provisions that prescribe how supplies must be treated. This means that irrespective of how the supply might be analysed under ordinary principles, the Act overrides this and specifies how the supply will be treated. This occurs, for example, in:
    - s 5(14B) for rights embedded in shares;
    - s 5(20) for warranty services provided to a non-resident warrantor; and
    - s 5(15) for supplies including residences.
21. The application of these sections is discussed briefly in [22] to [29] below. This list is not exhaustive. Other provisions in the Act may have similar effects.

Rights embedded in shares

22. Section 5(14B) was enacted (along with the definition of "associated supply" in s 2 and s 14(1B)) in response to the outcome in *CIR v Gulf Harbour Development Ltd* (2004) 21 NZTC 18,915 (CA) for supplies of equity securities and participatory securities ("shares"). *Gulf Harbour* is discussed from [31].

23. Section 5(14B) provides that if part of a supply of a share is the supply of a right to receive supplies of goods and services that are not exempt supplies, the supply of the right is treated as being a separate supply. This may mean the right is subject to GST rather than being an exempt financial service. For more information about s 5(14B), see "Goods and Services Tax – GST and Retirement Villages" *Tax Information Bulletin* Vol 27, No 11 (December 2015): 6 (IS 15/02), [142]–[155].

24. If elements other than the shares (part of which is the right to receive non-exempt supplies) are supplied under the contract, those other elements must still be considered to determine whether there is a single composite supply or multiple separate supplies.

Warranty services provided to a non-resident warrantor

25. Section 5(20) applies to the supply of services under a warranty covering imported goods. Commonly, two types of warranty cover imported goods:
    - a factory warranty offered by the non-resident manufacturer to the importer; and
    - an extended warranty offered by the importer or distributor to the final consumer.

26. When the final consumer makes a claim on the warranty, the importer or distributor makes two supplies, namely, a supply of:
    - goods and services to the final consumer; and
    - the service of remedying a defect under a factory warranty to the non-resident warrantor (zero-rated under s 11A(1)(ma)), who pays for the supply of that service.

27. Section 5(20) requires the supply of goods and services to the final consumer to be treated as the service of remedying a defect to the non-resident warrantor. It effectively ignores the supply of goods and services to the final consumer. This makes it more likely that the supply of warranty services by the importer or distributor can be zero-rated as a service supplied to a non-resident. For more information about ss 5(20) and 11A(1)(ma), see "Zero-rating of Warranty payments" *Tax Information Bulletin* Vol 14 No 11 (November 2002): 71.

Supplies including residences

28. Section 5(15) deems a supply that includes a principal place of residence to be a separate supply from the supply of any other real property included in the supply. The section also applies to a dwelling that has been rented out by the vendor exclusively for accommodation for at least the preceding five years. For example, when a farm (which includes the farmer's house and its surrounding curtilage) is sold, s 5(15) provides that the vendor's supply of the farmer's house and curtilage is a separate supply from the supply of the remainder of the farm. The GST treatment of each supply is determined separately. Usually, the supply of the remainder of the farm must be zero-rated under s 11(1)(mb) while the supply of the farmer's house and curtilage is not subject to GST because it is private and does not form part of the vendor's taxable activity.

29. Once s 5(15) has been applied, the remaining elements (other than the principal place of residence or dwelling) supplied under the contract must still be considered to determine whether there is a single composite supply or multiple separate supplies.

Whether the supply should be treated as a single composite supply

30. Once any relevant specific deeming provisions have been considered, the next step is to determine the nature of the supply. The approach of the New Zealand courts to identifying what has been supplied is to consider the true nature of the legal arrangements actually entered into and carried out by the supplier and the recipient in light of the surrounding circumstances: *Marac Life Assurance Ltd v CIR* (1986) 8 NZTC 5,086 (CA); *Gulf Harbour*.

31. In *Gulf Harbour*, the Court of Appeal emphasised the importance of identifying the true nature of the legal arrangements entered into between the supplier and the recipient when determining the GST consequences of a supply. In that case, the taxpayer supplied redeemable preference shares that included membership rights in a golf club (the rights were attached to the shares). The Commissioner argued the supply was of a golf club membership, so was subject to GST. Alternatively, the Commissioner argued that there were two supplies: a supply of a share and a supply of a golf club membership. The taxpayer argued that there was a single supply of a GST-exempt financial service (a share).

INTERPRETATION STATEMENTS

32. The Court of Appeal stated that the Commissioner's argument (at [39]) "involves putting the contractual arrangement to one side and looking at what in substance [the suppliers] were supplying …". The Court of Appeal considered the Commissioner was incorrectly looking at what "in substance" was being supplied, instead of looking at the contractual arrangement. The Court considered the "true nature" of a transaction must be ascertained by a careful consideration of the legal arrangements actually entered into and carried out – not by an assessment of the broad substance of the transaction, measured by the results intended and achieved, or of the overall economic consequences.
33. The Court of Appeal held that the golf club membership rights attached to each share were incidents of the share and no independent source or origin of those rights existed. As a result, the Court found for the taxpayer and held that there was a single supply of a share. The Act was subsequently amended in response to this outcome for supplies of equity securities and participatory securities: ss 2 (definition of "associated supply"), 5(14B) and 14(1B).
34. Where it is unclear whether there is one composite supply or multiple separate supplies under the contract, the transaction must be analysed further to determine the issue. Case law has established numerous principles to assist in this enquiry.
35. The leading New Zealand decision considering whether there is a single supply or multiple supplies is the High Court decision in *Auckland Institute*. In *Auckland Institute*, Hansen J considered the GST treatment of supplies to international students studying in New Zealand. The taxpayer provided tuition services to students coming to New Zealand from overseas. An associated company provided pre-arrival services. The students paid a single "global fee" to the taxpayer for all supplies from both the taxpayer and the associated company. One of the issues before the Court was whether it was appropriate to split the supply to enable the pre-arrival services to be zero-rated.
36. Hansen J discussed the approach of the House of Lords in *Card Protection Plan v Customs & Excise Commissioners* [2001] 2 All ER 143. In that case, the House of Lords considered whether a credit card protection plan offered to cardholders was a single composite supply or two independent supplies comprising the supply of VAT-exempt insurance and a separate supply of VAT-chargeable card registration services. The House of Lords concluded the dominant supply was of VAT-exempt insurance and the supply of the card registration services was ancillary to the exempt supply. In *Auckland Institute*, Hansen J summarised the principles from *Card Protection Plan* for determining whether a supply could be separated into multiple supplies (at [32]):
    - Every supply of a service must normally be regarded as distinct and independent.
    - A supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system.
    - The essential features of a transaction must be ascertained in order to determine whether the taxable person is supplying the customer, being a typical consumer, with several distinct principal services or with a single service.
    - There is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal service whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principal service. A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied.
    - Even if a single price is charged which may indicate a single supply, it must still be considered whether the arrangements indicated that the customer intended to purchase two distinct services.
37. After reviewing all the relevant authorities, Hansen J summarised the principles for determining whether a supply could be separated into multiple supplies (with one or more differing GST treatments) (at [36]):
    [a] In determining whether a supply may be apportioned for GST purposes, it is necessary to examine the true and substantial nature of the consideration given to determine whether there is a sufficient distinction between the allegedly different parts to make it reasonable to sever them and apportion them accordingly.
    [b] The enquiry is to determine whether one element of the transaction (or consideration given) is a necessary or integral part of another or whether it is merely ancillary to or incidental to that other element.
    [c] A service will be ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied.
38. Based on these principles, the Commissioner considers it helpful to ask three questions when analysing the transaction:
    - What is the true and substantial nature of what is supplied to the recipient?
    - What are the relationships between the elements supplied?
    - Is it reasonable to sever the elements into separate supplies?
39. When answering these questions, it is important to consider the supply from the perspective of a typical customer.

What is the true and substantial nature of what is supplied to the recipient?

40. The first question requires a registered person to identify the essential features of the arrangement – the true and substantial nature of what is supplied to the recipient for their payment. In doing so, it is important to examine what is supplied from the point of view of a "typical customer": *Card Protection Plan*. In *Auckland Institute*, Hansen J stated:

> [44] In my view, the attempt to characterise all of the services provided by International as a separate supply is based on a fundamental misconception. It overlooks **the need to examine the supply from the point of view of the consumer**. It focuses on the arrangements between AIS and International. **It fails to consider the true and substantial nature of the consideration given to the consumer**.
>
> [45] The importance of examining the services provided under the contract between the supplier and recipient emerges clearly from the decision of the Court of Appeal in *Wilson & Horton Ltd v C of IR* (1995) 17 NZTC 12,325. … Richardson J observed at 12,328 that **the statutory scheme is directed to contractual arrangements between the supplier and the recipient of the supply** … [Emphasis added]

41. The Commissioner considers that the phrase "the true and substantial nature" does not refer to an "in substance" analysis of the arrangement between the supplier and the recipient. Instead, "the true and substantial nature of the consideration given to the consumer" refers to what the recipient paid for and was supplied with. It requires an examination of the supply from the recipient's perspective. The true and substantial nature of what is provided to the recipient (the supply or supplies) is determined objectively: *British Airways plc v Customs & Excise Commissioners* [1990] STC 643 (CA).

42. The relevant arrangement is the one between the supplier and the recipient. It is irrelevant that the supplier may arrange some other party to deliver the goods or services to the recipient on the supplier's behalf. This was the view taken in *Auckland Institute*. In that case, one member of a group of companies contracted with overseas students to provide tuition services. The tuition services were provided to the students by another company in the group. Hansen J concluded that whether a service could be supplied separately (by another entity or a third party) was irrelevant in determining whether a single supply was made. Hansen J focused on the supply actually made under the contract with the recipient – "the true and substantial nature" of what was supplied to the recipient.

43. In this step, the focus is not on what one of the parties subjectively considered the supply was, or could have been. The relevant perspective is to consider what was supplied to the recipient as viewed objectively from the recipient's perspective. The fact a single price is charged to the recipient does not determine whether one or more than one supply is made. It is the actual supply made to the recipient that must be considered and not how the supply is invoiced or charged.

What are the relationships between the elements supplied?

44. It is also helpful to consider the relationships between the different elements supplied. The courts consider whether one element of the transaction is merely ancillary or incidental to, or a necessary or integral part of, any other element of the transaction. The phrases "ancillary or incidental to" and "necessary or integral part of" are different descriptions of a similar test: *C & E Commrs v United Biscuits (UK) Limited* [1992] STC 325 (Ct of Sess). The Court in that case noted that one description might be more appropriate for one set of facts and the other for a different set of facts. This view was echoed in *College of Estate Management v Customs & Excise Commissioners* [2005] UKHL 62, where the Court noted that the applicable test will depend on the facts of the case. If one element of the transaction is ancillary or integral to another (dominant) element of the transaction, then there will be a single composite supply, with the GST treatment of that supply following the dominant element.

45. Examples of elements that are ancillary or incidental to, or a necessary or integral part of, a dominant element include where the element is:

- not an aim in itself; instead the goods or services facilitate, contribute to, or enable the supply of the dominant part;
- a means of better enjoying the dominant supply;
- an optional extra and not in any real or substantial sense part of the consideration for which a payment is made.

46. In *Auckland Institute* Hansen J quoted from *Customs & Excise Commissioners v Wellington Private Hospital Ltd* [1997] STC 445 (EWCA) at 462, where Millett LJ noted that the issue is not whether one element is ancillary or incidental to, or even a necessary or integral part of, the whole, but whether one element is merely ancillary or incidental to, or a necessary or integral part of, any other element of the transaction. Hansen J stated (at [30]):

> The issue is not whether one element of a complex commercial transaction is ancillary or incidental to, or even a necessary or integral part of, the whole, **but whether one element of the transaction is merely ancillary or incidental to, or a necessary or integral part of, any other element of the transaction**. The reason why the former is the wrong question is that it leaves the real issue unresolved; whether there is a single or a multiple supply. **The proper inquiry is whether one element of the transaction is so dominated by another element as to lose any separate identity as a supply for fiscal purposes, leaving the latter, the dominant element of the transaction, as the only supply. If the elements of the transaction are not in this relationship with each other, each remains as a supply in its own right with its own separate fiscal consequences**. [Emphasis added]

47. Hansen J held that the pre-arrival services were ancillary or incidental to the principal supply of tuition services. Therefore, the supply of tuition services and pre-arrival services comprised a single supply of tuition services:

> [48] …They are goods and services provided to enable it (or AIS) to better perform the services supplied to students. Students did not contract for the provision of those services. It may be argued that the students benefited from them but, as Richardson J pointed out in *Wilson & Horton*, that is not the test.
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> …
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> [53] Notwithstanding the Commissioner's concession that pre-arrival services constitute a separate supply, I am of the view that **all of the services provided by International/AIS to students overseas are an integral part of the supply of tuition services**. In terms of the fourth of the propositions in the *Card Plan Protection* case, **I would regard those services as not constituting an aim in itself but as a means of better enjoying the principal service**. [Emphasis added]

48. Hansen J concluded (at [52] and [59]) that the pre-arrival services were ancillary and integral to the supply of tuition, because they facilitated the students undertaking a course of study.

49. Hansen J borrowed heavily from the United Kingdom VAT cases when deciding whether the pre-arrival services were ancillary or integral to the supply of tuition. Although the categories of goods and services that are exempt or zero-rated under the United Kingdom VAT legislation differ from those under the New Zealand legislation, Hansen J considered the approaches taken in the United Kingdom VAT cases to be of assistance.

50. In *College of Estate Management*, the College provided a distance-learning course and the necessary written materials to complete the course. The Court considered that the written materials were not ancillary to the provision of the course, but neither was the supply of the written materials an end in itself. Lord Rodger stated:

> [10] … But, since the court envisages that the principal supply may itself comprise more than one element, plainly, in cases where there is no ancillary supply, a single supply may still be made up of more than one element. **So where a taxpayer is involved in a transaction in which he performs several services, none of which can be singled out as the dominant or principal supply, it may nevertheless be necessary to consider whether, for tax purposes, they are properly to be regarded as elements of a single supply**. The supply of restaurant services is one example (see *Faaborg-Gelting Linien A/S v Finanzamt Flensburg C-231/94* [1996] All ER (EC) 656, [1996] ECR I-2395).
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> [11] … In the present case, however—leaving aside any allocation of a proportion of the price—it would be highly artificial, to say the least, to describe the printed materials as nothing more than a means for the students the better to enjoy the education supplied by the College. In reality, those materials were the means by which the students obtained most of their education.
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> [12] B**ut the mere fact that the supply of the printed materials cannot be described as ancillary does not mean that it is to be regarded as a separate supply for tax purposes**. One has still to decide whether, as a matter of statutory interpretation, the College should properly be regarded as making a separate supply of the printed materials or, rather, a single supply of education, of which the provision of the printed materials is merely one element. … **The question is whether, for tax purposes, these are to be treated as separate supplies or merely as elements in some over-arching single supply**. … [Emphasis added]

51. Lord Walker stated:

> [30] … **But there are other cases** (including the *Faaborg* case [C-231/94 *Faaborg-Gelting Linien A/S v Finanzamt Flensburg* [1996] STC 774 (ECJ)], the *Dr Beynon* case [*Beynon and Partners v Customs & Excise Commissioners* [2004] UKHL 53] and the present case) **in which it is inappropriate to analyse the transaction in terms of what is 'principal' and 'ancillary'**, and it is unhelpful to strain the natural meaning of 'ancillary' in an attempt to do so. Food is not ancillary to restaurant services; it is of central and indispensable importance to them; nevertheless there is a single supply of services (see the *Faaborg* case). Pharmaceuticals are not ancillary to medical care which requires the use of medication; again, they are of central and indispensable importance; nevertheless there is a single supply of services (see the *Dr Beynon* case).
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> …
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> [32] … **What the judge called 'a component part of a single supply' may be (in the fullest sense) essential to it—a restaurant with no food is almost a contradiction in terms, and could not supply its customers with anything—and yet the economic reality is that the restaurateur provides a single supply of services**. Without the need to resort to gnomic utterances such as 'the medium is the message', the same sort of relationship exists between the educational services which the College provides to a student who takes one of its distance-learning courses and the written materials which it provides to the student. [Emphasis added]

52. The House of Lords considered that the written materials were the means by which the students obtained most of their education. Their Lordships implied that the written materials were of central and indispensable importance to the educational services. The written materials were necessary to complete the course. The Court concluded that the supply of the written materials was part of the overall supply of education services.

53. *College of Estate Management* was recently distinguished in *Metropolitan International Schools v Revenue & Customs Commissioners* [2015] UKFTT 517 (TC). In *Metropolitan International* the Court said (at [66]) that "an element that is not an end in itself ranks as an ancillary element. Ancillary elements generally contribute to the better enjoyment of the principal element". On the facts of *Metropolitan International*, from a recipient's point of view, there was a supply of VAT-exempt manuals with a separate supply of optional educational services (which would not lead to any qualification unless the recipient undertook exams with a third party). This can be compared with *College of Estate Management*, where the facts showed that the overall characteristic of the supply was educational services (leading to a formal qualification) with the additional supply of written materials being part of the supply of the educational services.
54. An example of minor or peripheral parts of a composite supply is seen in *Tumble Tots (UK) Ltd v Revenue & Customs Commissioners* [2007] EWHC 103 Ch. In this case, it was held there was a single supply of membership of a club that conferred on a child the right to attendance at classes involving structured physical play. Other benefits received on admission to membership (a DVD, a CD, a gym bag, a membership card, personal accident insurance for a child while attending a class, and a subscription for a magazine) were not separate supplies, but were peripheral, and ancillary, to the supply of membership. Briggs J considered that it was "a matter of common sense" that the fee was for membership of the club and not the other benefits of membership (at [27]). To conclude otherwise "would be to allow the tail to wag the dog" (at [29]).

Is it reasonable to sever the elements into separate supplies?

55. Finally, it is necessary to consider whether it is reasonable to sever the elements of a transaction into separate supplies. This test requires taking an overall view, without over-zealous dissection, and to look for the essential (or dominant) purpose of the transaction: *College of Estate Management* (per Lord Walker); *Card Protection Plan*. A supply that comprises a single service from an economic point of view should not be artificially split: *Card Protection Plan*.
56. Similarly, in *Auckland Institute*, Hansen J cites Tipping J's judgment in *CIR v Smiths City Group Ltd* (1992) 14 NZTC 9,140 (HC). In *Smiths City*, Tipping J noted (at 9,144) that the Court "must decide as a matter of fact and degree whether there is in the transaction under scrutiny a sufficient distinction between the allegedly different parts to make it reasonable to sever them and apportion accordingly". If, on an objective examination, it is not reasonable to sever the different elements of the transaction, then there will be one composite supply only.
57. It appears from the cases cited above that the "reasonable" test focuses on the essential purpose of the transaction and on the elements themselves (whether there is a sufficient distinction between the elements to make it reasonable to sever them and apportion accordingly) rather than on whether a separate amount is charged for the element in question or on how easily a global fee can be apportioned.
58. Further, one of the principles from *Card Protection Plan* for determining whether a supply could be separated into multiple supplies (as summarised in *Auckland Institute* (at [32]) is:

    > Even if a single price is charged which may indicate a single supply, it must still be considered whether the arrangements indicated that the customer intended to purchase two distinct services.

59. Hansen J also stated in *Auckland Institute* (at [61]):

    > **I do not see the fee structure as a decisive consideration** but I think it tends to confirm that the services which the plaintiff claims are covered by the overseas assistance fee are more realistically to be seen as among the costs which AIS incurs in providing tuition services. [Emphasis added]

60. Hansen J's comments relate to an argument by the Commissioner that as there was no material difference between the fees charged to domestic and overseas students, the fee structure confirmed that a separate supply of overseas assistance services was not made to students. Hansen J did not consider that the fee structure was determinative.
61. And in *Customs & Excise Commissioners v British Telecommunications Plc* [1999] BTC 5,273 (which was cited in *Auckland Institute* of Studies) Lord Slynn said:

    > **On the authorities it is clear that the fact that one 'package price' is charged without separate charge for individual supplies being specified does not prevent there being two separate supplies for VAT purposes. In my opinion the fact that separate charges are identified in a contract or on an invoice does not on a consideration of all the circumstances necessarily prevent the various supplies from constituting one composite transaction nor does it prevent one supply from being ancillary to another supply which for VAT purposes is the dominant supply**. Even though it may be desirable to approach each supply as if it were a separate supply and even though each supply in a composite transaction may be an independent separate supply the **essential features of a transaction** may show that one supply is ancillary to another and that it is the latter that for VAT purposes is to be treated as the supply. [Emphasis added]

62. Lord Hope (also in *British Telecommunications*) similarly considered that in all cases the essential features of the transaction must be identified. All the circumstances of the transaction must be considered and no one factor will determine whether there is a separate supply. Whether a separate charge is made or whether a separate price can be identified, whether the service could be supplied separately or whether the supplies are "physically and economically dissociable" (for example, where there is a supply of goods and a supply of services and the price for each supply can be identified) are not determinative.

GST treatment of a single composite supply

63. If it is determined that there is a single composite supply, it is still necessary to determine whether there are any other specific provisions in the Act that may apply. For example, the following matters need to be considered.

Some supplies of land must be zero-rated

64. The first is whether the single composite supply includes land and must be zero-rated. Section 11(1)(mb) provides that a supply that wholly or partly consists of land must be zero-rated if at settlement date:
    - the supply is made by a vendor who is a registered person to a purchaser who is a registered person;
    - the purchaser acquires the goods (including land) supplied with the intention of using them for making taxable supplies; and
    - the land included in the supply is **not** intended to be used as the purchaser's principal place of residence or the principal place of residence of a relative of the purchaser.
65. If s 11(1)(mb) applies, the single composite supply must be zero–rated, regardless of whether the land is the dominant element of the supply.

Other supplies may be partly zero-rated

66. Sections 11, 11A, 11AB and 11B provide that some taxable supplies must be zero-rated. While all the zero-rating provisions apply to "a supply", some indicate that part of the supply can be zero-rated by using the words "to the extent that" or other equivalent wording. Where a provision of ss 11, 11A, 11AB or 11B requires part of a supply to be zero-rated, the different elements of a single composite supply may be subject to different GST treatments.
67. These different GST treatments are achieved through s 5(14). Section 5(14) applies when a supply is subject to GST at the standard rate but any of the provisions of ss 11, 11A, 11AB or 11B require part of the supply to be zero-rated. If s 5(14) applies, the zero-rated part is treated as being a separate supply. For a more detailed discussion of s 5(14), see "IS 08/01: GST — Role of section 5(14) of the Goods and Services Tax Act 1985 in Regard to the Zero-rating of Part of a Supply" *Tax Information Bulletin* Vol 20, No 5 (June 2008): 8.

Otherwise, GST treatment follows dominant element

68. If the provisions of ss 11, 11A, 11AB or 11B do not apply to the single composite supply, the GST treatment of that supply will follow the dominant element of the supply. If there is no dominant element (for example, the supply is made up of several equally important elements that are integral to each other), the GST treatment will be determined by the overall characteristics of the single composite supply.

GST treatment of multiple separate supplies

69. If there are multiple separate supplies, the relevant provisions of the Act are applied to each supply. This means that it is necessary to consider each separately identified supply to determine whether any of the specific provisions (such as, for example, s 11(1)(mb)) apply.
70. In some situations, a recipient may pay a global amount for multiple supplies with different GST treatments (for example, taxable supplies and exempt supplies). Section 10(18) provides that GST should be calculated on that part of the consideration that is properly attributable to the taxable supply. This means the consideration must be apportioned between taxable supplies and non-taxable supplies or exempt supplies.

Examples

71. The following examples illustrate how the law applies. All persons mentioned in the examples are GST registered.

Example 1 – Services supplied to overseas students to help them to move to New Zealand

72. Ecological Education Ltd offers education services to students in New Zealand. The education services are intended to provide students with a qualification in eco-management. Almost all of Ecological Education's students are from overseas. To help students moving to New Zealand, Ecological Education provides various pre-arrival services to the students while they are still overseas (for example, interpreting and translating services, assistance with immigration procedures and the completion of enrolment applications). Ecological Education charges the student a single fee for the tuition costs and the pre-arrival services.

Are the pre-arrival services separate zero-rated supplies?

73. No. The pre-arrival services are part of a single composite supply of standard-rated education services, so are also standard-rated.

74. First, it is necessary to identify the supply by considering the true nature of the legal arrangements actually entered into and carried out by the supplier and the recipient in light of the surrounding circumstances. It is evident from the arrangement that Ecological Education supplies multiple elements, namely education services to the students in New Zealand, and various pre-arrival services to students while they are still overseas, all for a single fee.

75. To decide whether Ecological Education has made one composite supply or multiple separate supplies it is helpful to consider the true and substantive nature of what is supplied to the student from the recipient's (that is, the student's) perspective. From the student's point of view, the dominant supply is of education services. Considering the relationship between the elements supplied, the pre-arrival services are ancillary or incidental to the supply of education services. The pre-arrival services are not aims in themselves, but are a means of better enjoying the education services. Accordingly, there is a single composite supply of education services that is subject to GST at the standard rate.

Example 2 – Tablet provided as part of mortgage promotion

76. Andrew needs to obtain a mortgage of $250,000 to purchase land for the expansion of his manufacturing business. He approaches New Bank, because of its recent mortgage promotion. He gets his mortgage approved and, as part of the mortgage promotion, he receives a new tablet.

77. If these were separate supplies, the mortgage would be an exempt supply of financial services under s 14(1)(a). The supply of the tablet would be a taxable supply under s 8.

Is the supply of the tablet subject to GST?

78. No. The tablet is an incidental part of a single composite, exempt supply of the mortgage, so is also exempt from GST.

79. The true nature of the legal arrangement is a loan from New Bank to Andrew (secured by a mortgage over the land). The contract also includes a supply of goods from New Bank to Andrew. Therefore, New Bank supplies multiple elements to Andrew, namely a loan and a tablet. The question is whether these two elements are a single composite supply or multiple separate supplies. As with example 1, the nature of the supply has to be considered from the recipient's (that is, Andrew's) perspective.

80. Unlike example 1, the supply of the tablet cannot be considered ancillary to the supply of financial services, because it does not facilitate, contribute to or enable the supply of the dominant part of the transaction (the mortgage). The supply of the tablet does not directly affect the supply of the mortgage in any material sense.

81. However, the supply of the tablet is incidental, minor or peripheral to the dominant element of the supply. Andrew would not have entered into a mortgage simply to receive the tablet. Obtaining the tablet is not an aim in itself. Andrew's aim is to obtain a mortgage. Objectively, the supply of the tablet does not change or facilitate the dominant element, which is the mortgage. The supply of the tablet is also not sufficiently distinct from the supply of the mortgage to make it reasonable to sever and apportion the parts. It is the supply of the mortgage that triggers the supply of the tablet.

82. In this situation, there is a single composite, exempt supply of a mortgage. The supply of the tablet is an incidental or peripheral supply to the dominant supply of GST-exempt financial services. This means all elements of the supply under the agreement are exempt for GST.

Example 3 – Tablet available at reduced price as part of mortgage promotion

83. As a variation to the facts of example 2, Andrew still needs to obtain a mortgage to purchase land for the expansion of his manufacturing business. He approaches New Bank, because of its recent mortgage promotion. New Bank's mortgage promotion is that for new borrowings in the range of what Andrew wants to borrow, it is offering customers the opportunity to purchase for $500 a new tablet valued at $1,500. Andrew's mortgage is approved and, as part of the mortgage promotion, he takes up the opportunity to get a new tablet for $500.

Is the supply of the tablet subject to GST?

84. Yes. The supply of the tablet is separate to the supply of the mortgage. Therefore, although the mortgage is exempt as the supply of financial services, the tablet is a taxable supply.

85. Unlike example 2, the tablet is not incidental to taking out the mortgage. Obtaining the tablet was an aim in itself. While Andrew's primary aim was to obtain a mortgage, obtaining the new tablet was a separate objective. As in example 2, the supply of the tablet does not change or facilitate the dominant element, which is the mortgage. However, in this case the supply of the tablet is sufficiently distinct from the supply of the mortgage to make it reasonable to sever and apportion the elements. The tablet was not part of the supply of the mortgage – it was separately pursued by Andrew for further consideration.

Example 4 – Theatre tickets purchased on credit card and credit card surcharge

86. To celebrate the expansion of his business, Andrew buys theatre tickets for all his employees. Andrew purchases the tickets from the theatre box office using his credit card. The theatre charges Andrew a credit card surcharge.

Is the credit card surcharge a separate supply?

87. No. The credit card surcharge is part of a single composite supply of standard rated theatre tickets.

88. The true nature of the legal arrangement is for the supply of multiple elements, namely theatre tickets and the facility to pay for those tickets by credit card, with each element itemised and charged for separately. It is necessary to consider whether there is any relationship between the supply of the tickets and the supply of the payment facility (being the facility to pay with a credit card). Viewing the arrangement between Andrew and the theatre from Andrew's point of view, the dominant supply is the supply of theatre tickets. While he is paying a surcharge for using his credit card, the dominant supply remains the supply of theatre tickets. Andrew's ability to use his credit card is not an aim in itself. The facility to pay by credit card is ancillary to the dominant supply of the theatre tickets, in the sense that it enables the supply to occur.

89. There is a single composite, taxable supply of theatre tickets. This means all the elements of the supply under the agreement are subject to GST.

Example 5 – Residential accommodation and cleaning services

90. Andrew's parents are looking to move into a villa that is part of a retirement complex. The villa stands alone and, at this stage, Andrew's parents do not require any care. When considering the options, Andrew convinces his parents that they should get the option offered by the retirement complex of having a cleaner come to the villa weekly.

91. If these are separate supplies, the supply of the right to live in the villa would be an exempt supply of residential accommodation under s 14(1)(c). The supply of the cleaning services would be a taxable supply under s 8.

Are the cleaning services subject to GST?

92. Yes. The cleaning services are a separate supply to the supply of the right to live in the villa.

93. The dominant supply is the right to live in the villa. In some respects, the cleaning services could be seen as ancillary or incidental to the right to live in the villa. However, in this case, the cleaning services are not necessary or incidental to the right to live in the villa – they are an extra service that not all recipients require. In this case, a separate amount is charged for the cleaning services. This fact may indicate multiple separate supplies, but it is not determinative. It must still be considered whether the arrangements indicate that Andrew's parents intended to purchase two distinct services. While Andrew's parents' primary aim was to obtain the right to live in the villa, obtaining the cleaning services was a separate objective. In this case the supply of the cleaning services is sufficiently distinct from the supply of the right to live in the villa to make it reasonable to sever and apportion the elements.

Example 6 – Loyalty points with a credit card

94. Electronics Ltd (an electronics retail chain) operates a customer loyalty programme in its retail stores. Registered customers receive loyalty points for shopping at Electronics Ltd and these loyalty points entitle them to future discounts at Electronics Ltd.

95. New Bank wants to expand its credit card business. It decides to enter into an arrangement with Electronics Ltd. Under the terms of the arrangement, New Bank and Electronics Ltd intend to provide additional loyalty points in Electronics Ltd's loyalty programme to registered customers who use the New Bank credit card to purchase goods from Electronics Ltd.

96. New Bank pays Electronics Ltd for services associated with promoting and maintaining the loyalty programme. These services include access to Electronics Ltd's customer database, marketing the loyalty programme (including the provision of all marketing material), encouraging customers to use the New Bank credit card, managing all non-credit card aspects of the loyalty programme, accepting in-store account payments, assisting the retail stores to accept in-store account payments and provide loyalty points, and training the retail store employees on how the loyalty programme works.

97. Electronics Ltd wants to know how it should treat the services it supplies to New Bank for GST purposes.

Should any of the services be exempt as a separate supply of financial services?

98. No. The services are all part of a single composite supply of standard-rated marketing and promotional services.

99. The contract between New Bank and Electronics Ltd provides for the supply of several services from Electronics Ltd to New Bank. It is necessary to consider whether there is any relationship between the various services provided. The focus must be on what is supplied to the recipient. The recipient of these services is New Bank, despite the fact some of the services are supplied directly to New Bank's customers (for example, answering questions about the loyalty programme).

100. The supply could be broken down into separate elements (some taxable at the standard rate and some exempt). However, this would not appropriately reflect what is supplied to the recipient, New Bank. The supply from Electronics Ltd to New Bank is a supply of all the elements. From New Bank's perspective, it has contracted with Electronics Ltd for the supply of all those elements as a single package of marketing and promotional services. It is helpful to consider the relationship between the different elements of the supply when deciding whether Electronics Ltd has made one composite supply or multiple separate supplies to New Bank.

101. The dominant element of the supply to New Bank is marketing and promotional services for the loyalty programme. While Electronics Ltd may, as part of that dominant element, be providing financial services, such as accepting account payments, these are ancillary to the dominant element when packaged together. This is because these parts of the supply are not aims in themselves. They are included so that New Bank can better enjoy the dominant element of the supply of marketing and promotional services. It is also helpful to consider the essential purpose of the transaction between New Bank and Electronics Ltd, namely, the provision of a single package of marketing and promotional services. It would not be reasonable to sever the elements of the transaction into separate supplies.

102. In this situation there is a single composite, taxable supply of marketing and promotional services. The GST treatment of the dominant element of the supply (marketing and promotional services) is a taxable supply at the standard rate. Therefore, the ancillary or incidental supplies are also taxable at the standard rate.

Example 7 – Treatment of transitional services supplied as part of the sale of a business (that includes the supply of land)

103. "QB 12/07: Goods and Services Tax – Treatment of Transitional Services Supplied as Part of the Sale of a Business (that Includes the Supply of Land)" *Tax Information Bulletin* Vol 24, No 6 (July 2012): 65 provides an example of the application of the principles set out in this Interpretation Statement.

104. QB 12/07 considers whether transitional services provided by the vendor as part of the sale of a business (that includes the supply of land) will be part of a single composite supply and therefore zero-rated for GST purposes where:
    - the services and the sale of the business form part of the same contractual arrangement, and
    - the services are not provided for a separately identifiable consideration.

105. The examples consider two fact scenarios. The first scenario is where the vendor provides basic transitional services as part of the sale of the business. The vendor agrees to be onsite for a week from the day of transfer to show the purchaser how the business operates, to answer any questions that the purchaser has and to facilitate a smooth transfer of the business.

106. In this situation there is a single composite, zero-rated supply of a business that includes land. The dominant element of the agreement is the supply of the business (including land). The services are not extensive and are provided for only a short period of time. Further, the nature of the services is to facilitate a smooth transfer of the business to the purchaser. Consequently, the services provided are ancillary and incidental to the supply of the business. They do not constitute an aim in themselves, but rather are a means for the purchaser to better enjoy the supply of the business.

107. The second scenario is where the vendor provides extensive transitional services as part of the sale of the business. The vendor agrees to manage the business for the purchaser for an initial period of 12 months.

108. In this situation there are two separate supplies - one of the land/business and one of transitional services. The transitional services are relatively extensive and are provided over a 12 month period. They are an aim in themselves for the purchaser who requires someone to run the business on an on-going basis. The fact that the services are not provided for a separately identifiable consideration is not determinative. The supply of these transitional services should be standard-rated, as ss 11(1)(mb) and 5(24) do not apply.

109. As noted in the example, no amount of consideration has been attributed to the transitional services. Therefore, the total consideration provided for under the agreement will need to be apportioned between the zero-rated supply (the business/land) and the standard-rated supply (the transitional services).

110. The Commissioner considers that these outcomes are consistent with the general principles set out and applied in this Interpretation Statement.

References

Related rulings/statements

"Financial Planning Fees – GST Treatment" *Tax Information Bulletin* Vol 13, No 7 (July 2001): 37 (IS 0079)

"Goods and Services Tax - GST and Retirement Villages" *Tax Information Bulletin* Vol 27, No 11 (December 2015): 6 (IS 15/02)

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"QB 12/07: Goods and Services Tax – Treatment of Transitional Services Supplied as Part of the Sale of a Business (that Includes the Supply of Land)" *Tax Information Bulletin* Vol 24, No 6 (July 2012): 65

"Zero-rating of Warranty Payments" *Tax Information Bulletin* Vol 14, No 11 (November 2002): 71

Subject references

Apportionment
GST
Multiple supplies
Single supply

Legislative references

Goods and Services Tax Act 1985, ss 5, 8, 10, 11, 11A, 11AB, 11B, 14

Case references

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College of Estate Management v Customs & Excise Commissioners [2005] UKHL 62, 4 All ER 933

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Customs & Excise Commissioners v United Biscuits (UK) Limited [1992] STC 325

Customs & Excise Commissioners v Wellington Private Hospital Ltd [1997] STC 445 (EWCA)

Marac Life Assurance Ltd v CIR (1986) 8 NZTC 5,086 (CA)

Metropolitan International Schools v Revenue & Customs Commissioners [2015] UKFTT 517 (TC)

Tumble Tots (UK) Ltd v Revenue & Customs Commissioners [2007] EWHC 103 Ch

Appendix – Legislation

Goods and Services Tax Act 1985

1. Section 5(1), (14), (14B), (15) and (20) provide:

5 Meaning of term "supply"

(1) For the purposes of this Act, the term supply includes all forms of supply.

…

(14) If a supply is charged with a tax under section 8, but section 11, 11A, 11AB, 11B, or 11C requires part of the supply to be charged at the rate of 0%, that part of the supply is treated as being a separate supply.

(14B) If part of a supply of an equity security or participatory security is the supply of a right to receive supplies of goods and services that are not exempt supplies, the supply of the right is treated as being a supply of goods and services made for a consideration.

(15) When either of the following supplies are included in a supply, they are deemed to be a separate supply from the supply of any other real property that is included in the supply:

(a) a supply of a principal place of residence:

(b) a supply referred to in section 14(1)(d).

…

(20) A supply of services to which section 11A(1)(ma) applies is treated as the only supply of services for the consideration provided by the warrantor.

2. Section 8(1) provides:

8 Imposition of goods and services tax on supply

(1) Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 15% on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after 1 October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.

…

3. Section 10(18) provides:

10 Value of supply of goods and services

…

(18) Where a taxable supply is not the only matter to which a consideration relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it.

…

4. Section 11 provides:

11 Zero-rating of goods

(1) A supply of goods that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:

(a) the supplier has entered the goods for export under the Customs and Excise Act 1996 and the goods have been exported by the supplier; or

(b) the goods have been deemed to be entered for export under the Customs and Excise Act 1996 and the goods have been exported by the supplier; or

(c) the supplier has satisfied the Commissioner that the goods have been exported by the supplier to a place outside New Zealand; or

(d) subject to subsection (4), the supplier will enter the goods for export under the Customs and Excise Act 1996 in the course of, or as a condition of, making the supply, and will export the goods; or

(e) subject to subsection (4), the goods will be deemed to be entered for export under the Customs and Excise Act 1996 and will be exported by the supplier in the course of, or as a condition of, making the supply; or

(eb) subject to subsection (4), the goods supplied—

(i) are supplied to a recipient who is a non-resident; and

(ii) have been entered for export under the Customs and Excise Act 1996 by the supplier or will be entered for export by the supplier in the course of or as a condition of making the supply; and

(iii) are exported by the recipient; and

(iv) are not intended by the recipient for later importation into New Zealand for use other than in making taxable supplies or exempt supplies, with the absence of such an intention being confirmed by the recipient in a document retained by the supplier; and

(v) are not used or altered by the recipient before being exported, except to the extent necessary to prepare the goods for export; and

(vi) leave New Zealand under an arrangement agreed by the supplier and the recipient at or before the time of the supply; and

(vii) do not leave New Zealand in the possession of a passenger or crew member of an aircraft or ship; or

(f) goods that would otherwise have been exported are destroyed, die or cease to exist in circumstances beyond the control of both the supplier and the recipient; or

(g) subject to subsection (6), the goods are supplied by a supplier who is licensed under section 12 of the Customs and Excise Act 1996, if—

(i) the supplier has been licensed by the chief executive of the New Zealand Customs Service to operate a sealed bag system; and

(ii) the goods are supplied in accordance with the sealed bag system; and

(iii) the goods are entered, or are deemed to be entered, for export under the Customs and Excise Act 1996; or

(h) the goods and services are supplied—

(i) by a supplier who is licensed under section 12 of the Customs and Excise Act 1996; and

(ii) within an area licensed under section 12 of the Customs and Excise Act 1996 as a customs controlled area for the processing of persons arriving in or departing from New Zealand; and

(iii) to either—

(A) an inbound air traveller; or

(B) an outbound air traveller who picks up the goods upon returning to New Zealand; or

(i) subject to subsection (7), the supply of a boat or an aircraft by way of sale to a recipient who exports the boat or aircraft under its own power to a place outside New Zealand; or

(j) the goods are not situated in New Zealand at the time of supply and—

(i) the goods are not situated in New Zealand at the time of delivery to the recipient:

(ii) the recipient pays tax under section 12 on the importation of the goods into New Zealand; or

(k) the goods have been supplied in the course of repairing, renovating, modifying or treating goods to which section 11A(1)(h) or 11A(1)(i) applies and the goods supplied—

(i) are wrought into, affixed to, attached to or otherwise form part of those other goods; or

(ii) are consumable goods that become unusable or worthless as a direct result of being used in the repair, renovation, modification or treatment process; or

(ka) the goods are supplied for use on, or the use of, a pleasure craft, being a temporary import within the meaning of section 116 of the Customs and Excise Act 1996, that cause or enable the craft to sail, or that ensure the safety of passengers and crew on the craft; or

(l) the goods supplied are consumable stores intended for use on—

(i) an aircraft on a flight, or going, to a destination outside New Zealand; or

(ii) a fishing ship outside, or going outside, New Zealand fisheries waters; or

(iib) a ship, other than a pleasure craft, carrying consumable stores to a foreign-going ship or to a fishing ship that meets the requirements in subparagraph (ii); or

(iii) a foreign-going ship; or

(iv) a pleasure craft that is a temporary import within the meaning of section 116 of the Customs and Excise Act 1996 going to a destination outside New Zealand fisheries waters; or

(m) the supply to a registered person of a taxable activity, or part of a taxable activity, that is a going concern at the time of the supply, if—

(i) the supplier and the recipient agree that the supply is the supply of a going concern, and their agreement is recorded in a document; and

(ii) the supplier and the recipient intend that the supply is of a taxable activity, or part of a taxable activity, that is capable of being carried on as a going concern by the recipient; or

(mb) the supply wholly or partly consists of land, being a supply—

(i) made by a registered person to another registered person who acquires the goods with the intention of using them for making taxable supplies; and

(ii) that is not a supply of land intended to be used as a principal place of residence of the recipient of the supply or a person associated with them under section 2A(1)(c); or

(n) the supply of new fine metal, being the first supply of the new fine metal after its refining, by the refiner to a dealer in fine metal, for the purpose of supplying the fine metal for use as an investment item; or

(o) the goods are supplied to or by the Crown as consideration for a supply—

(i) for which there is no payment of a price; and

(ii) that is chargeable at the rate of 0% under section 11A(1)(s) or (t); or

(p) the goods are—

(i) jigs, patterns, templates, dies, punches, and similar machine tools to be used in New Zealand solely to manufacture goods that will be for export from New Zealand; and

(ii) supplied to a recipient who is a non-resident, and not a registered person.

(2) For the purpose of subsection (1)(n), if a person is both a refiner of and a dealer in fine metal, the new fine metal is treated as having been supplied to the dealer at a time immediately before the making of an exempt supply of the new fine metal.

(3) Subsection (1)(a) to (1)(l) do not apply to a supply of goods by a registered person if—

(a) the registered person, or another person associated with the registered person, has deducted, under section 20(3), input tax as defined in section 3A(1)(c) in respect of the goods; or

(b) the goods have been or will be reimported into New Zealand by the supplier.

(3B) Subsection (3)(a) does not apply to a supply of goods if the recipient gives the registered person at or before the time of the supply an undertaking, and records the undertaking in a document, that neither the recipient nor an associated person will cause the goods to be reimported into New Zealand in a condition that is substantially the same as the condition the goods were in when the supply was charged with tax under subsection (1)(a) to (1)(l).

(3C) Despite subsection (3B), a registered person is treated as having supplied goods in the course or furtherance of a taxable activity and must be charged with tax at the rate specified in section 8 if—

(a) the supply of the goods by the registered person was charged with tax under subsection (1)(a) to (l); and

(b) the goods are imported into New Zealand; and

(c) the goods are reacquired by the registered person in substantially the same condition as the condition the goods were in when the supply was charged with tax under subsection (1)(a) to (l); and

(d) the registered person deducted under section 20(3) input tax as defined in section 3A(1)(c) in relation to the original supply of the goods under subsection (1)(a) to (l).

(3D) Subsection (3C)—

(a) applies at the time the goods are reacquired by the registered person:

(b) does not apply if tax is paid under section 12 on the importation of the goods into New Zealand.

(4) If subsection (1)(d), (e), or (eb) applies and the person required to export the goods does not do so within 28 days beginning on the day of the time of supply or a longer period that the Commissioner has allowed under subsection (5), the supply of the goods must be charged with tax at the rate specified in section 8 despite subsection (1)(d), (e), and (eb) but subject to subsection (1)(a), (1)(b) and subsection (5).

(5) The Commissioner may extend the 28-day period before a supply of goods is charged with tax at the rate specified in section 8 if the Commissioner has determined, after the supplier has applied, that—

(a) circumstances beyond the control of the supplier and the recipient have prevented, or will prevent, the export of the goods within 28 days beginning on the day of the time of supply; or

(b) due to the nature of the supply, it is not practicable for the supplier to export the goods, or a class of the goods, within 28 days beginning on the day of the time of supply.

(6) If subsection (1)(g) applies and the goods cannot be evidenced, as specified by the chief executive of the New Zealand Customs Service in accordance with the sealed bag system, as being exported within 28 days beginning on the day of the time of supply, despite subsection (1)(g), the supply must be charged with tax at the rate specified in section 8.

(7) Subsection (1)(i) applies to the supply of a boat or an aircraft, if—

(a) the boat or aircraft is exported within 60 days beginning on the date on which the recipient or the recipient's agent takes physical possession of it, or within a longer period as the Commissioner may allow under subsection (8); and

(b) the vendor or the purchaser provides the Commissioner with such documentation and undertakings as the Commissioner may require in relation to—

(i) records of the sale of the supply; and

(ii) limitations on dealings in and the uses to which the boat or aircraft will be put before export; and

(iii) the proposed and actual date of export.

(8) The Commissioner may extend the 60-day period if the Commissioner is satisfied, upon the application of the supplier, that circumstances beyond the control of the supplier and the recipient have prevented, or will prevent, the export of the boat or aircraft within the period.

(8B) Whether a supply of goods is zero-rated under subsection (1)(mb) is determined at the time of settlement of the transaction relating to the supply.

(8C) Despite subsections (1)(mb) and (8B), a supplier may choose to apply the provisions of this Act applying before the changes made by the Taxation (GST and Remedial Matters) Act 2010 if they enter into a binding agreement before 1 April 2011 for which the time of supply is on or after that date.

(8D) For the purposes of the zero-rating of land rules,—

(a) a supply that is an assignment or surrender of an interest in land, is a supply under subsection (1)(mb) if it meets the requirements set out in that subsection:

(b) the supply of an interest in land is not a supply under subsection (1)(mb), despite meeting the requirements set out in that subsection if—

(i) the supply is made periodically; and

(ii) for an amount paid or payable under the agreement for the supply in advance of, or contemporaneously with, the supply being made, the payment—

(A) totals 25% or less of the consideration specified in the agreement; and

(B) relates to the longer of 1 year and the shortest possible fixed term of the agreement; and

(C) is not itself a regular payment under the agreement:

(c) a supply of an interest in land by way of a procurement by a third party of an existing lease is a supply under subsection (1)(mb) if it meets the requirements set out in that subsection.

(9) For the purpose of this section—

aircraft has the meaning set out in section 2 of the Civil Aviation Act 1990

consumable stores means—

(a) goods that passengers and crew on board an aircraft or a ship have available to consume; and

(b) goods necessary to operate or maintain an aircraft or a ship, including fuel and lubricants but excluding spare parts and equipment

fishing ship has the meaning set out in section 2 of the Maritime Transport Act 1994

foreign-going ship means a ship on a voyage, or going, to a destination outside New Zealand, other than a pleasure craft or a fishing ship

New Zealand fisheries waters has the meaning set out in section 2 of the Fisheries Act 1996

pleasure craft has the meaning set out in section 2 of the Maritime Transport Act 1994

sealed bag system means a system under which a supplier—

(a) is licensed to operate an export warehouse; and

(b) may, with the authorisation of the chief executive of the New Zealand Customs Service, and subject to any conditions that the chief executive may specify, supply goods in a sealed bag to individuals intending to travel overseas within 5 days beginning on the day of the time of supply; and

(c) must provide evidence that the goods have been exported from New Zealand within 5 days beginning on the day of the time of supply, and if conditions have been specified by the chief executive of the New Zealand Customs Service, in accordance with those conditions

ship has the meaning set out in section 2 of the Maritime Transport Act 1994.

5. Section 11A provides:

11A Zero-rating of services

(1) A supply of services that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:

(a) the services, not being ancillary transport activities such as loading, unloading and handling, are the transport of passengers or goods—

(i) from a place outside New Zealand to another place outside New Zealand; or

(ii) from a place in New Zealand to a place outside New Zealand; or

(iii) from a place outside New Zealand to a place in New Zealand; or

(b) the services are the transport of passengers from a place in New Zealand to another place in New Zealand to the extent that the transport is by aircraft, as defined in section 2 of the Civil Aviation Act 1990, and is international carriage for the purpose of that Act; or

(bb) the services are the transport of passengers from a place in New Zealand to another place in New Zealand by sea as part of an international cruise if either the first place of departure, or the final place of destination, of the cruise is outside New Zealand; or

(c) the services, including ancillary transport activities such as loading, unloading and handling, are the transport of goods from a place in New Zealand to another place in New Zealand to the extent that the services are supplied by the same supplier as part of the supply of services to which paragraph (a)(ii) or (a)(iii) applies; or

(cb) the services, including ancillary activities such as loading, unloading, handling and storing, are the transport of household goods from a place in New Zealand to another place in New Zealand, if—

- (i) the services are supplied to a person who, at the time of the supply, is non-resident and outside New Zealand; and
- (ii) the goods are entered for home consumption under the Customs and Excise Act 1996; and
- (iii) the arrangement for the supply of the services is made before the goods are entered; and
- (iv) the services are reasonably expected to be completed within the period of 28 days that begins on the date of entry of the goods; or

(d) the services are the insuring, or the arranging of the insurance, or the arranging of the transport of passengers or goods to which any one of paragraphs (a) to (cb) applies; or

(e) the services are supplied directly in connection with land situated outside New Zealand or any improvement to the land; or

(f) the services are supplied directly in connection with moveable personal property, other than choses in action, situated outside New Zealand when the services are performed; or

(g) the services are supplied to overseas postal organisations for the delivery in New Zealand of postal articles mailed outside New Zealand; or

(h) the services are supplied directly in connection with goods supplied from outside New Zealand and whose destination is outside New Zealand, including stores for craft, only if the goods are not removed from the ship or aircraft in which they arrived while the ship or aircraft is in New Zealand; or

(i) the services are supplied directly in connection with goods referred to in section 116 of the Customs and Excise Act 1996; or

(j) the services are physically performed outside New Zealand or are the arranging of services that are physically performed outside New Zealand, other than a supply of remote services provided to a person resident in New Zealand who is not a registered person; or

(k) subject to subsection (2), the services are supplied to a person who is a non-resident and who is outside New Zealand at the time the services are performed, not being services which are—

- (i) supplied directly in connection with—
  - (A) land situated in New Zealand or any improvement to the land; or
  - (B) moveable personal property, other than choses in action or goods to which paragraph (h) or (i) applies, situated in New Zealand at the time the services are performed; or
- (ii) the acceptance of an obligation to refrain from carrying on a taxable activity, to the extent that the activity would have occurred within New Zealand; or

(l) subject to subsection (2), the services are the supply of information to a person who is a non-resident and who is outside New Zealand at the time the services are performed, if the services are supplied directly in connection with moveable personal property situated in New Zealand at the time the services are performed; or

(m) the services are supplied—

- (i) directly in connection with goods, the supply of which was subject to any one of section 11(1)(a) to (eb); and
- (ii) to a recipient who, when the services are performed, is a non-resident and outside New Zealand; or

(maa) the services are supplied—

- (i) directly in connection with goods, the supply of which is subject to section 11(1)(p); and
- (ii) to a recipient who, when the services are performed, is a non-resident and not a registered person; or

(ma) the services relate to goods under warranty to the extent that the services are—

- (i) provided under the warranty; and
- (ii) supplied for consideration that is given by a warrantor who is a non-resident, not a registered person and who is outside New Zealand at the time the services are performed; and
- (iii) in respect of goods that were subject to tax under section 12(1); or

(n) subject to subsection (4), the services are—

- (i) the filing, prosecution, granting, maintenance, transfer, assignment, licensing or enforcement of intellectual property rights, including patents, designs, trade marks, copyrights, plant variety rights, know-how, confidential information, trade secrets or similar rights; or

(ii) other services in respect of rights listed in subparagraph (i), including services involved in the making of searches, the giving of advice, opposing a grant or seeking the revocation of the rights, or opposing steps taken to enforce the rights; or

(o) the services are the acceptance of an obligation to refrain from pursuing or exercising in whole or in part rights listed in paragraph (n) to the extent that the rights are for use outside New Zealand; or

(p) the services are the acceptance of an obligation to refrain from carrying on a taxable activity if the activity would have occurred outside New Zealand; or

(q) the services are financial services that are supplied in respect of a taxable period, by a registered person who has made an election under section 20F, to a registered person who makes supplies of goods and services such that taxable supplies that are not charged with tax at the rate of 0% under this paragraph or under paragraph (r) make up not less than 75% of the total value of the supplies in respect of—

(i) a 12-month period that includes the taxable period; or

(ii) a period acceptable to the Commissioner; or

(r) the services are financial services that are supplied in respect of a taxable period, by a registered person who has made an election under section 20F, to a person who is a member of a group of companies for the purposes of section IA 6 of the Income Tax Act 2007 and—

(i) the members of the group make supplies of goods and services to persons who are not members of the group in respect of—

(A) a 12-month period that includes the taxable period; or

(B) a period acceptable to the Commissioner; and

(ii) not less than 75% of the total value of the supplies referred to in subparagraph (i) consists of taxable supplies that are not charged with tax at the rate of 0% under this paragraph or under paragraph (q); or

(s) the services are an emissions unit and the supply is the transfer of the emissions unit, other than a transfer by the Crown under—

(i) an agreement relating to a project to reduce emissions:

(ii) a negotiated greenhouse agreement, to a person because the person exceeds the milestone targets under the agreement:

(t) the services are an emissions unit, and the supply is the surrender of the emissions unit under section 63 of the Climate Change Response Act 2002; or

(u) the services are supplied to or by the Crown as consideration for a supply—

(i) for which there is no payment of a price; and

(ii) that is chargeable at the rate of 0% under paragraph (s) or (t); or

(v) *[Repealed]*

(w) the supply is a sale or other disposal of services that are a unit—

(i) issued by reference to the sequestration, or avoidance of emission, of human-induced greenhouse gases; and

(ii) other than an emissions unit; and

(iii) verified to an internationally recognised standard; or

(x) the services are remote services to which section 8(3)(c) applies that are provided to a registered person and the supplier has chosen under section 8(4D) to treat the supply as made in New Zealand.

(1B) Subsection (1)(j) does not apply to a supply of services that is treated by section 8(4B) as being made in New Zealand unless the nature of the services is such that the services can be physically received at no time and place other than the time and place at which the services are physically performed.

(2) Subsection (1)(k) and (1)(l) do not apply to a supply of services under an agreement that is entered into, whether directly or indirectly, with a person (person A) who is a non-resident if—

(a) the performance of the services is, or it is reasonably foreseeable at the time the agreement is entered into that the performance of the services will be, received in New Zealand by another person (person B), including—

(i) an employee of person A; or

(ii) if person A is a company, a director of the company; and

(b) it is reasonably foreseeable, at the time the agreement is entered into, that person B will not receive the performance of the services in the course of making taxable or exempt supplies.

(3) For the purpose of subsection (1)(k), (1)(l) and (1)(ma), and subsection (1)(n) as modified by subsection (4)(b), outside New Zealand, for a company or an unincorporated body that is not resident, includes a minor presence in New Zealand, or a presence that is not effectively connected with the supply.

(3B) For the purpose of subsection (1)(k), outside New Zealand, for a natural person, includes a minor presence in New Zealand that is not directly in connection with the supply.

(4) Subsection (1)(n) applies only to the extent that—

(a) the rights are for use outside New Zealand; or

(b) the services are supplied to a person who is a non-resident and who is outside New Zealand when the services are performed.

(5) This section does not apply to supplies of telecommunications services.

(6) The availability of a deduction under subsection (1)(q) and (r) must be determined using a method allowed by section 20E.

(7) Subsection (1)(x) does not apply to a supply of services for which the supplier subsequently makes an election under section 24(5B).

6. Section 11AB provides:

11AB Zero-rating of telecommunications services

A supply of services that is chargeable with tax under section 8 must be charged at the rate of 0% if—

(a) the services are the supply of telecommunications services to an overseas telecommunications supplier by a telecommunications supplier who is a resident; or

(b) the services are the supply of telecommunications services to a person, not being an overseas telecommunications supplier, for a telecommunications service that is initiated outside New Zealand under section 8(9).

7. Section 11B provides:

11B Zero-rating of some supplies by territorial authorities, some supplies involving contributions to local authorities

(1) A supply of services that is chargeable with tax under section 8 must be charged at the rate of 0% if the supplier is a territorial authority and the consideration for the supply is proceeds from the local authorities petroleum tax paid to the supplier under section 198 of the Local Government Act 1974.

(1B) If a supply under section 5(7B) of goods and services by a local authority to a registered person is chargeable with tax under section 8, the supply must be charged at the rate of 0% to the extent that the contribution made by the registered person to the local authority consists of land.

(1C) If a supply under section 5(7C) of goods and services by a person to a local authority is chargeable with tax under section 8, the supply must be charged at the rate of 0% if the local authority is a registered person.

(1D) *[Repealed]*

(1E) *[Repealed]*

(2) For the purpose of subsection (1)—

local authorities petroleum tax is local authorities petroleum tax levied in accordance with Part 11 of the Local Government Act 1974

territorial authority means a territorial authority within the meaning of the Local Government Act 2002.

8. Section 14(1)(a) and (c) and (1B)(a)-(c) provides:

14 Exempt supplies

(1) The following supplies of goods and services shall be exempt from tax:

(a) the supply of any financial services (together with the supply of any other goods and services, supplied by the supplier of those financial services, which are reasonably incidental and necessary to that supply of financial services), not being a supply referred to in subsection (1B):

…

(c) the supply of accommodation in any dwelling by way of—

(i) hire; or

(ii) a service occupancy agreement; or

(iii) a licence to occupy:

…

(1B) The following supplies are excluded from the exemption under subsection (1):

(a) a supply of financial services that, in the absence of subsection (1)(a), would be charged with tax at the rate of zero per cent under section 11A:

(b) a supply described in paragraph (b) of the definition of "associated supply":

(c) a supply of goods and services which (although being part of a supply of goods and services which, but for this paragraph, would be an exempt supply under subsection (1)(a)) is not in itself, as between the supplier of that first-mentioned supply and the recipient, a supply of financial services in respect of which subsection (1)(a) applies.

…

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.

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 331/3% 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.

[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".

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.

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:

    > (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 T*erminals (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.

[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).

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]
>
> [30] JF Burrows and RI Carter Statute Law in New Zealand (4th ed, LexisNexis, Wellington, 2009) at 203.
>
> [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].
>
> [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]

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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 Commissioners* [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.

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

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.

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*).

[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.

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

Schedule 32

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

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> 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]

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> 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:
>
> 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.

[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.

> 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.

"Excessive" accumulation of funds

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]

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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 × $300 = $240).

Example 5 – Scholarships for New Zealand students to study overseas

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

Example 6 – Sending employees to overseas conference

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

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

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

Example 7 – Sending a speaker to an overseas conference

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

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

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

[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]).

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

Step one – determine the organisation's "total funds" for the year

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.

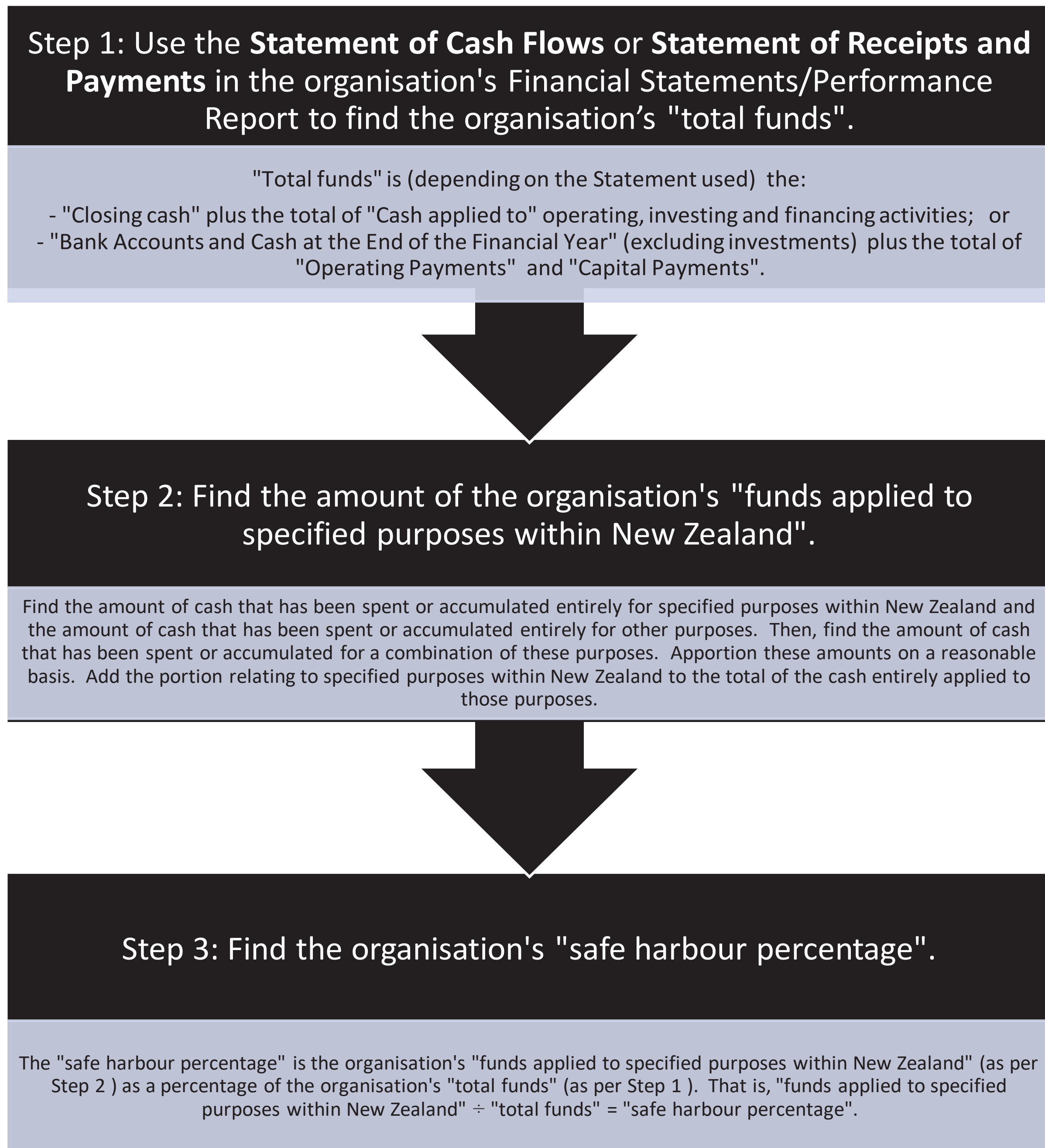
[6] Cash and cash equivalents on hand will not include investments made in prior years. Investments made in the current year are treated as an application of funds at the time the investment is acquired (see [297] and [298]).

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 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 × 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 dark grey 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 light grey 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 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 to a combination of purposes apportioned on above percentage:	**17,176**	**4,844**	**22,020**
Total funds applied	**$18,726**	**$5,294**	**$24,020**

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Subject references

Applied
Donee organisation
Funds
New Zealand
Wholly or mainly

Legislative references

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Cluster Munitions Act 2009: s 5(1)
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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—

total gifts × $33^{1}/_{3}$%.

Definition of item in formula

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

Administrative *requirements*

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

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

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

Refundable credits

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

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

LD 2 Exclusions

Section LD 1 does not apply to—

(a) an absentee:

(b) a company:

(c) a public authority:

(d) a Maori authority:

(e) an unincorporated body:

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

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

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

LD 3 Meaning of charitable or other public benefit gift

Meaning

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

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

LEGAL DECISIONS – CASE NOTES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

Application for restoration to the Register of Companies

Case	*Commercial Management Ltd v Commissioner of Inland Revenue* [2018] NZHC 2224
Decision date	28 August 2018
Act(s)	Companies Act 1993 s 329
Keywords	Register of Companies, restoration, balancing exercise

Summary

The applicants sought orders to restore five companies to Register of Companies ("the Register"). The Court considered that on balance, the private and public interests favoured restoration of the relevant companies to the Register.

Impact

The judgment confirms the balancing exercise conducted by the court when considering an application to restore a company to the Register.

Facts

The applicants sought restoration of the relevant companies relying primarily on the decision of the High Court in *FB Duvall Ltd v Commissioner of Inland Revenue* HC Auckland CIV-2009-404-1193, 15 December 2011, where Ellis J determined that the Commissioner of Inland Revenue ("the Commissioner") had erred in refusing to accept late objections by a number of companies controlled by the late Mr J G Russell or his firm in relation to assessments for GST. In that matter the Commissioner was ordered to accept and consider the objections.

Since that judgment, there have been on-going negotiations between the parties to resolve the dispute. The applicants maintained that other companies, including those that are the subject of this application, are in a comparable position to the plaintiffs in the *FB Duvall* case and wanted negotiations to include these companies. The Commissioner had advised that no such settlement could proceed, noting that the companies were struck off and no longer existed.

Decision

The Court confirmed that as the Commissioner was a party to the litigation, she had standing to oppose the application. As for the form of the proceeding, the Court accepted that the application was not "run-of-the-mill" but was not especially complex either factually or legally. The Court noted that as the application, opposition and affidavits along with detailed submissions had been filed, there had been no handicap caused by the format of the proceeding and the better course was to simply dispose of the matter on that basis.

The Court confirmed that the factors the Court should have regard to in an application under s 329 are those set out in *Re Saxpack Foods Ltd* [1994] 1 NZLR 605 (HC).

In particular, the Court referred to the delay of time since the companies were struck off, with his Honour inferring from *Re Saxpack* that there will be times when an application will fail where there is no reasonable explanation for the delay and the delay may result in prejudice. The five companies in this matter were removed between seven and twenty-two years ago. The Court recognised that these appeared to be extreme periods of time but went on to say that there is an explanation, namely that it was not until the decision in *FB Duvall* and the negotiations that followed that the need to apply for restoration became apparent to the applicants. Further, his Honour considered that the delay caused no obvious prejudice to the Commissioner.

The delay was therefore not a bar to the application albeit the Court stated that such a delay meant it must look carefully at the other relevant factors.

The Court also referred to the fact that s 329(1)(A) provides that the Court is obliged to have regard to the reasons for the company's removal and whether those grounds still exist. The Court accepted that it was fair to conclude that the grounds for removal from the Register had not changed and that this weighed against restoration.

The Commissioner submitted that as the companies were not carrying on business at the time of removal there was no proper reason for them to be restored. However, the Court held that whether there was a proper reason to order restoration depended on whether it was proper to do so to enable the applicants to test the issue of whether the companies were in the same position as the plaintiffs in *FB Duvall*. His Honour held that this factor weighed in favour of granting the application.

Additionally, the Court did not regard the fact that there was no live issue between the five defunct companies and the Commissioner as being a factor to influence the outcome of this application.

The Court saw the balancing exercise of private and public interests as the dispositive and most difficult aspect of the case. From the perspective of the applicants and the five defunct companies, they clearly envisaged a private advantage to be gained by restoration. The Court also held that there may be a public interest involved too, namely that the restoration of the five defunct companies to the Register would enable five corporate taxpayers - as they would then be - to pursue their rights through the methods available to all taxpayers. The Court stated that the right to do so is fundamental and there is public good in its reinforcement.

The Commissioner referred to the long history of litigation between Mr Russell and the Commissioner, and she submitted that this application was just another example of Mr Russell, and those associated with Mr Russell, looking to prolong meritless claims against the Commissioner.

The Court felt that it would not be appropriate in the context of this application to form any conclusions based on the history of litigation between Mr Russell and the Commissioner, either as to the propriety of the applicants' motives in seeking to have the five defunct companies restored or as to the merits of the claims they might wish to make. While his Honour accepted that it is not in the public interest that the Commissioner be embroiled in what on its face appeared to be long standing disputes, there was a pre-existing dispute between the *FB Duvall* plaintiffs and the Commissioner and the marginal cost of including five additional claimants would be minimal.

On balance, the Court's view was that the private and public interests favoured the making of the orders sought.

Application to extend time for SOP dismissed

Case	*Vicente Badillo Lopez v Commissioner of Inland Revenue* [2018] NZHC 2329
Decision date	5 September 2018
Act(s)	High Court Rules 2016; Tax Administration Act 1994
Keywords	Tax dispute, extension, correct applicant

Summary

Two companies were in dispute with the Commissioner of Inland Revenue ("the Commissioner") concerning GST input credits and had two months to issue Statements of Position ("SOPs") in response to the Commissioner's SOPs. Vicente Lopez, the sole director and shareholder of both companies, applied in his own name to extend time for the companies to issue their SOPs. The Commissioner successfully applied to dismiss Mr Lopez's application, both for lack of jurisdiction (the companies should have applied, not Mr Lopez) and, even if the companies had made the application, it would not have succeeded as the grounds in s 89M(11) of the Tax Administration Act 1994 ("the TAA") for an extension of time were not met.

Impact

It is the taxpayer company, not a director or shareholder, that must apply under s 89M(11) of the TAA for an extension of time to issue a SOP.

An application for an extension of time under s 89M(11) must include an allegation that there are issues in dispute that have not been previously discussed between the Commissioner and taxpayer. Even if there is such an allegation, the Court will consider whether, factually, the issues in dispute have been previously discussed or the taxpayer has been given ample opportunity to raise and discuss any issues but has not pursued those opportunities.

Facts

The applicant, Vincente Lopez, was the sole director and shareholder of Galaxy Private Transport Ltd and Mars.XXX Ltd ("the Companies"). The Companies were in dispute with the Commissioner (GST input credits and income tax) and the Commissioner had issued SOPs to each Company respectively.

Mr Lopez applied to the High Court for a year's extension under 89M(11) of the TAA to reply to the SOPs issued by the Commissioner, and, in the alternative, on the basis of exceptional circumstances under 89K of the TAA.

The Commissioner opposed the application on the grounds that the Court had no jurisdiction to hear and determine the application:

> Mr Lopez had purported to file an originating application when he requires the Court's leave to do so under r 19.5 of the High Court Rules ("the HCR"). Without such leave the proceeding is invalid;
>
> The appropriate applicants are the Companies and there should be a separate application from each company, rather than a single application from Mr Lopez;
>
> Mr Lopez, who is not a barrister or solicitor, is unable to bring an application on behalf of the companies under the *Mannix* rule (*Re GJ Mannix Ltd* [1984] 1 NZLR 309 (CA)), without leave of the Court.

Decision

The Court noted that any issues between the Commissioner and the Companies can only be resolved in proceedings to which they are parties. There is no dispute under Part 4A of the TAA between Mr Lopez and the Commissioner, rather any disputes are between the Companies and the Commissioner.

It is the Companies which must seek the extension of time and they have not done so. The proceeding does not provide a jurisdictional basis to grant an extension of time to the Companies and Mr Lopez's application therefore failed on procedural grounds.

For completeness the Court considered the substantive merits of the extension application (putting aside that the application was made by Mr Lopez, not the Companies), with the principles relevant to a strikeout being considered. Rule 15.1(1)(a) of the HCR provides that the court may strike out all or part of a pleading if it discloses no reasonably arguable cause of action, defence, or case appropriate to the nature of the pleading. The Court may dismiss a proceeding on the same basis.

Under 89M(11) of the TAA an extension must be applied for before the expiry of the response period and it must have been unreasonable to respond within the response period due to there being issues not previously discussed. While Mr Lopez had filed the application before the expiry of the response period, the grounds relied on did not include an allegation that the issues in dispute were not previously discussed. Nor would such a submission, if made, appear sustainable in light of the evidence filed by the Commissioner.

There was substantial correspondence between the Inland Revenue and Mr Lopez, on behalf of the companies, and he had been given several opportunities to supply information, discuss the audits and explain what the claimed GST expenses related to; meetings had been arranged which Mr Lopez refused to attend. Input credits were allowed where clear explanations and/or verifiable proof was given of the claimed expenditure.

As Mr Lopez had had ample opportunities to raise and discuss issues in dispute with the Commissioner, but did not pursue those opportunities, the Court found that, therefore, s 89M(11) of the TAA did not appear to apply.

The Court also noted that the "exceptional circumstances" exception in s 89K of the TAA which Mr Lopez relied on did not apply as the section only becomes operative once a taxpayer (belatedly) submits a SOP to the Commissioner. As the Companies have not filed their respective SOPs they were not in the position to request the Commissioner to exercise her discretion to treat the SOPs as if they had been filed within the appropriate response period.

Accordingly, even if Mr Lopez were able to overcome the procedural obstacles, the Commissioner's strike out application would have succeeded on substantive grounds.

The Court dismissed Mr Lopez's application and awarded costs.

An application for orders appointing a replacement liquidator

Case	*Commissioner of Inland Revenue v Mercantile Developments Limited* [2018] CIV-2018-404-1920
Decision date	26 September 2018
Act(s)	Companies Act 1993 ss 241, 248, 260, 283 and 318; High Court Rules 2016 r 7.23, Part 19
Keywords	Liquidation, replacement liquidator, prospective creditor, originating application

Summary

The Commissioner of Inland Revenue ("the Commissioner") applied for orders appointing a replacement liquidator for Mercantile Developments Limited ("the Respondent") by way of originating application without notice. The Court agreed that the Commissioner had standing as a prospective creditor to bring the application and that it was in the public interest that an experienced liquidator be appointed.

Impact

The Commissioner is a prospective creditor by virtue of amounts proposed in a Notice of Proposed Adjustment. As a prospective creditor, the Commissioner has standing to apply for the appointment of a liquidator.

Facts

The Respondent was placed in liquidation in June 1981 and the Court appointed a liquidator. The liquidator resigned on 9 April 1997, did not appoint a replacement liquidator and the office of the liquidator has been vacant since then.

The Commissioner is in dispute with the Respondent in relation to losses claimed in relation to the 1982 to 2010 income years. The Commissioner had issued a Notice of Proposed Adjustment proposing to disallow the losses. The Commissioner asserted that it was essential to have a liquidator appointed to enable progression of the tax dispute process.

The Commissioner sought orders to commence the application by way of originating application without notice; leave to proceed with the application as a prospective creditor; and orders appointing an experienced liquidator.

Decision

The Court granted the Commissioner leave to bring the application by way of originating application without notice. The Court found that the Commissioner is a prospective creditor by virtue of the disputed amounts set out in the Notice of Proposed Adjustment because there was a real prospect of the Commissioner being a creditor in the future. Accordingly, the Court found that as a prospective creditor the Commissioner has standing to bring the application.

The Court also agreed that it was in the public interest that the affairs of the Respondent be put in order by an experienced liquidator. The Court noted that there were several provisions of the Companies Act 1993 currently being breached and appointment of a liquidator would enable the Commissioner to progress the dispute by issuing the disclosure notice and statement of position.

High Court confirms deductions for bad debts not available as operating a "Benevolence on the Conscience Loan Fund" not a money lending business

Case	*Boon Gunn Hong v Commissioner of Inland Revenue* [2018] NZHC 2539
Decision date	27 September 2018
Act(s)	Income Tax Act 2007 ss DA 1, DB 31(1), DB31(3); Tax Administration Act 1994 ss 15B, 141A; Insolvency Act 2006 s 304
Keywords	bad debt, deduction, reasonable care, lending business, business test, financial arrangement, shortfall penalties

Summary

Unsuccessful taxpayer appeal of a decision in the Taxation Review Authority ("the TRA"). The High Court confirmed the Commissioner of Inland Revenue's ("the Commissioner") assessments disallowing two deductions for bad debts under s DB 31 of the Income Tax Act 2007 ("the ITA") and imposing shortfall penalties under s 141A for not taking reasonable care. The appellant was found not to carry on a business of holding financial arrangements, nor had he discharged the onus of proving that he wrote the debts off as bad in the 2011 income year.

Impact

This is the first High Court authority on the application of s DB 31 of the ITA (or its predecessors) in 23 years, the latest being *Budget Rent a Car Ltd v Commissioner of Inland Revenue* (1995) 17 NZTC 12,263. It is also the first time the High Court considers subsection DB 31(1)(a)(ii) of the ITA which was inserted in the legislation on 27 February 2014 with retrospective effect to debts that go bad on or after 1 April 2008.

The High Court approached s DB 31 consistent with previous TRA decisions and applied settled legal principles (including the business test as laid down in *Grieve v Commissioner of Inland Revenue* [1984] 1 NZLR 101). For the most part, the case turned on its facts.

Facts

In a decision dated 29 March 2018, the TRA upheld the Commissioner's assessments disallowing two deductions claimed in the appellant's 2011 income tax return for bad debts in the amount of $50,000 and $122,280 respectively and imposing shortfall penalties under s 141A of the Tax Administration Act 1994 ("the TAA") on the basis the appellant had not taken reasonable care ("the TRA's Decision"). The loans were advanced in 2006 to two clients of the appellant's legal practice out of a fund which the appellant had created for this purpose in 2005 and which he called his "Benevolence on the Conscience Loan Fund". The clients were facing financial difficulties.

On appeal, the High Court upheld the TRA's Decision.

Decision

The High Court found the appellant had not shown, according to his own accounting procedures, that the loans had been written off in the 2011 income year. Jagose J noted that except for the appellant's own assertion there was no evidence that his office administrator, Ms Chan, had entered the write-offs in the spreadsheet during the 2011 income year. Ms Chan's absence as a witness was unexplained. An inference was therefore available that what she may have said in evidence would not have assisted the appellant.

The High Court further found that the debtors (both being natural persons) had not been released at law from making further payments as they had not been discharged from bankruptcy under s 304 of the Insolvency Act 2006 at the time the deductions were claimed. Section DB 31(1)(a)(ii) of the ITA was therefore not applicable.

His Honour applied the business test in *Grieve* and held that the appellant was not carrying on, even in part, a lending business for the purpose of deriving assessible income. The appellant's only hope of financial return was if grateful clients elected to reimburse him. The lending was a side project which was not carried on in an organised and coherent manner, or with sufficient continuity and extent to constitute a business.

There was also an insufficient connection between the appellant's legal services business and the financial arrangements for which deductions were sought. Jagose J noted the two do not easily or naturally co-exist as lending money to clients raises significant issues under the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008.

The High Court upheld TRA's findings that the appellant failed to take reasonable care on the basis that a reasonable person in the appellant's circumstances would have: (a) taken sufficient steps to understand relevant taxpayer obligations; (b) kept adequate books and records in regards to the Claimed Loans and the reasons for assessing the debts had gone bad; and (c) filed returns and paid tax on time.

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