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IRRUIP9: Donee organisations – clarifying when funds are applied wholly or mainly to specified purposes within New Zealand

1. The New Zealand Law Society appreciates the opportunity to comment on Issues Paper IRRUIP9 *Donee organisations – clarifying when funds applied wholly or mainly to specified purposes within New Zealand* (Issues Paper).

2. The Law Society's comments on the Issues Paper are outlined below. Further details regarding the "wholly or mainly" requirement are then set out in the Appendix.

"Wholly or mainly" means all or most, i.e. more than 50%, not "something close to 100%"

3. The principal focus of this submission is the Commissioner's preliminary view that the reference in section LD 3(2)(a) of the Income Tax Act 2007 (ITA 2007) to an organisation's funds being applied "*wholly or mainly*" to specified purposes within New Zealand means that "*something close to 100%*" or "*substantially all*" of an organisation's funds need to be applied to such purposes within New Zealand.

4. The Law Society's concerns are that the Commissioner's preliminary view on this aspect of section LD 3(2)(a):

   (a) is incorrect as a matter of law, because the ordinary and natural meaning of the words "wholly or mainly", the weight of case law authority (and in particular New Zealand tax case laws, namely *Commissioner of Inland Revenue v Mitchell* (1986) 8 NZTC and *Newman Tours Limited v Commissioner of Inland Revenue* (1989) 11 NZTC 6,027) and the deliberate adoption of the word "mainly" with reference to that case law as part of the rewrite of the income tax legislation, all support the contrary position that "mainly" is a straight alternative to "wholly" and is to be read in its most natural sense of "*for the most part*" or "*more than anything else*", i.e. in percentage terms, more than 50%; and

   (b) contradicts the long-standing and well-settled interpretation and application of this aspect of section LD 3(2)(a) (and predecessor provisions) in accordance with the ordinary and natural meaning of the words used in the section.

5. The interpretation of this aspect of section LD 3(2)(a) is discussed in further detail in the Appendix.

6. The Issues Paper indicates that the Commissioner considers that the long-standing and well-settled interpretation and application of this aspect of section LD 3(2)(a), in accordance with the ordinary and natural meaning of the words "*wholly or mainly*" may not be appropriate from a tax policy perspective. If that is the case, this should be dealt with through the generic tax policy process, not under the guise of reinterpreting the words used in the section.

Other aspects of the Issues Paper

Scope for application of funds to non-specified purposes

7. The Law Society agrees that the terms of section LD 3(2)(a) do not require an organisation to apply all of its funds to specified purposes (within or outside New Zealand) or need only apply its funds "*wholly or mainly*" to such purposes (and in doing so, must also apply its funds wholly or mainly to such purposes "*within New Zealand*") – that is, the provision leaves scope for the application of funds to specified purposes within New Zealand, specified purposes outside New Zealand and non-specified purposes. On this point, the Law Society notes the comments of the Court of Appeal in *Molloy v Commissioner of Inland Revenue* [1981] 1 NZLR 688, at 690 to 691.

8. The Issues Paper acknowledges this point in the summary at paragraph 12 (first bullet point) but elsewhere the position is unclear. For example, the discussion of calculation issues (from paragraph 71 onwards) refers to application of funds to "*specified purposes within New Zealand"* and "*non-qualifying purposes*" as if the latter included both specified purposes outside New Zealand and non-specified purposes. This is not how the phrases are defined at paragraph 11 of the Issues Paper.

Purposes, rather than expenditure, "within New Zealand"

9. The Law Society agrees with the Commissioner's view (supported by *Case T50* (1998) 18 NZTC 8,346 and *Commissioner of Inland Revenue v Dick* [2002] 2 NZLR 560) that the "*within New Zealand*" requirement in section LD 3(2)(a) (and also in section LD 3(2)(b), (c) and (d)) relates to where the specified purposes of an organisation are advanced, not where the organisation's funds are spent (as per paragraphs 17 and 19 to 24 of the Issues Paper).

10. It would assist donee organisations if the Commissioner clarified her approach to a range of examples dealing with expenditure outside New Zealand to advance purposes within New Zealand, and vice versa. For example, in relation to the advancement of education or health, in what circumstances would bringing someone from overseas to New Zealand for tuition or treatment, or sending someone overseas for tuition or treatment, or contributing to a research project overseas with a view to the research benefiting New Zealand, be viewed by the Commissioner as advancing those purposes "within New Zealand".

"Applied" has a wide meaning

11. The Law Society agrees with the Commissioner's initial view (supported by Sands J's stance in *General Nursing Council for Scotland v CIR* (1929) 14 TC 645 and *FCT v Bargwanna (as trustees of the Kalos Metron Charitable Trust)* [2012] HCA 11) that, in the context of section LD 3(2)(a), funds "applied" to specified purposes by an organisation can include holding (and investing) funds for such purposes (as per paragraphs 25 to 28 of the Issues Paper).

12. The Law Society notes that this is also consistent with the accepted position in relation to charitable entities' assets being "applied" for charitable purposes based on the dedication of

their assets to such purposes under their rules (see, for example, *Calder Construction Co Ltd v Commissioner of Land Revenue* [1963] NZLR 921).

"Funds" not limited to donations

13. The Law Society agrees with the Commissioner's view that an organisation's "funds" are not limited to the monetary gifts that are received by the organisation (as confirmed by the Court of Appeal in *Molloy*, noted above, at 690 to 691) and that, in its most natural sense, the word as used in section LD 3(2)(a) refers to all monies or "financial resources" of the relevant organisation (as per paragraphs 80 to 88 of the Issues Paper).

Calculating funds applied to specified purposes within New Zealand

14. The Law Society notes that if, as outlined above and in the Appendix, the words "*wholly or mainly*" in section LD 3(2)(a) are correctly interpreted as having their ordinary and natural meaning, so that an organisation must apply all or most of its funds (i.e. more than 50%) to specified purposes within New Zealand, issues relating to the calculation of funds applied to specified purposes within New Zealand versus other purposes will not be as problematic as under the Commissioner's suggested reinterpretation of those words. (The Commissioner's suggestion that "wholly or mainly" can be reinterpreted to mean that "*close to 100%*" or "*90% or more*" of an organisation's funds must be applied to specified purposes within New Zealand leaves little margin for an organisation to work with and accentuates the compliance intensive calculation issues dealt with in paragraphs 78 to 114 of the Issues Paper.)

15. The Law Society notes that it would still assist donee organisations for the Commissioner to clarify her proposed approach to assessing an organisation's application of its funds to purposes within New Zealand (where an organisation does not apply its funds wholly to such purposes). In this regard, the Law Society:

    (a) accepts that a practical approach to undertaking a *preliminary assessment* of an organisation's application of its funds is to look at expenditure incurred or payments made each year (as per paragraphs 99 to 103, and 118 to 119, of the Issues Paper), with apportionment of expenditure such as rent, overheads and personnel costs in appropriate circumstances (as per the example in paragraphs 107 to 114, and 119, of the Issues Paper); but

    (b) notes that this must not detract from the position that funds may be "applied" to specified purposes within New Zealand (and other purposes) without being spent (as discussed above), and that section LD 3(2)(a) requires an *overall assessment* of the organisation's position in relation to the application of its funds wholly or mainly to specified purposes within New Zealand (as acknowledged, for example, at paragraphs 104 to 106 of the Issues Paper); and

    (c) suggests that it would be appropriate for the Commissioner to signal to donee organisations that if an organisation applies, say, 60% or more of its funds each year (i.e., clearly more than 50%) to specified purposes within New Zealand, the Commissioner will treat this as a "safe harbour" within which an organisation would be presumed to meet the "wholly or mainly" requirement.

Funds maintained "exclusively" for specified purposes within New Zealand

16. The Law Society disagrees with the Commissioner's apparent suggestion (at paragraph 122 of the Issues Paper) that a donee organisation fund under section LD 3(2)(c) or (d) cannot be used at all to support the "parent" organisation's operating expenditure. The parent organisation's use of part of the fund to meet a reasonable share of the costs to the organisation of maintaining the fund does not detract from the position that the fund is maintained exclusively for the purpose of providing money for one or more specified purposes within New Zealand.

17. The Law Society also notes that it would be appropriate for the Commissioner to clarify that providing money for specified purposes within New Zealand can include providing money to the "parent" organisation for its advancement of such purposes.

Position of donors in relation to their gifts to approved donee organisations

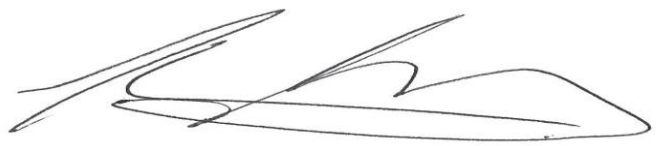
18. The Issues Paper touches on, but does not discuss in any detail, the implications of an organisation that is eligible for donee organisation status, or at least has been approved by Inland Revenue, becoming ineligible, or being found to be ineligible, for that status (e.g., on the basis that its funds are no longer applied at least mainly to specified purposes within New Zealand).

19. As noted in the Law Society's submission on the changes to the ITA 2007 relating to entities deregistered under the Charities Act 2005[1] it would seem appropriate for donors to be protected in relation to tax incentives claimed for monetary gifts to such an organisation, at least where the organisation is included on Inland Revenue's public list of approved donee organisations at the time of a gift. (In the case of organisations registered and then deregistered under the Charities Act 2005, such protection is effectively provided by section LD 3(2)(ab) of the ITA 2007).

Further information

20. This submission was prepared by the Law Society's Tax Law Committee. If you wish to discuss this further, please do not hesitate to contact the Tax Law Committee convenor Neil Russ, through the committee secretary Jo Holland (04 463 2967 / jo.holland@lawsociety.org.nz).

Yours faithfully



Kathryn Beck
President

[1] See NZLS submission of 5 February 2014 on the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill*, at paragraphs 145 to 146.

APPENDIX

Application of funds "wholly or mainly" to specified purposes within New Zealand

"Wholly or mainly" requirement under section LD 3(2)(a) of the ITA 2007

1. Section LD 3(2)(a) of the ITA 2007 describes the first category of donee organisation to which tax-incentivised gifts can be made. The provision refers to an organisation's funds being applied "wholly or mainly" to specified purposes within New Zealand.

Appropriate approach to interpretation of section LD 3(2)(a)

2. As in the case of other statutory provisions, the meaning of section LD 3(2)(a) is to be ascertained from its text and in light of its purpose, as per section 5 of the Interpretation Act 1999. In relation to implementing this approach to interpretation, the Supreme Court has confirmed that (*Stiassny v Commissioner of Inland Revenue* [2012] NZSC 106, at [23]):

> *"In this country, the general approach to the interpretation of a revenue statute is much the same as for other statutes. The purpose of a taxing provision may be a guide to its meaning and intended application.[17] 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.[18]"*
>
> *[17] Interpretation Act 1999, s 5 and see Commissioner of Inland Revenue v Alcan New Zealand Ltd [1994] 3 NZLR 439 (CA) at 444 per McKay J.*
>
> *[18] John Burrows and Ross Carter Statute Law in New Zealand (4th ed, LexisNexis, Wellington, 2009) at 217.*

3. This approach is to be applied in relation to interpreting the *"wholly or mainly"* requirement under section LD 3(2)(a).

The most natural sense of "wholly or mainly" is all or most, i.e. more than 50%

4. In relation to reading the words *"wholly or mainly"* in section LD 3(2)(a) in their *"most natural sense"* (as per *Stiassny*, above):

   (a) the standard function of the word "or" is as a conjunction "*used to link alternatives*" (as per the Oxford Concise English Dictionary, 10th Edition, 1999, and confirmed by case law), so that an organisation's funds may be applied *either* "wholly" for specified purposes within New Zealand *or* "mainly" for such purposes within New Zealand; and

   (b) as acknowledged by the Commissioner (at paragraph 30 of the Issues Paper), the ordinary meaning of the adverb "mainly" is "*for the most part; in the main; as the chief thing, chiefly, principally*" (as per the Short Oxford English Dictionary on Historical Principles). Similarly, the Oxford Concise English Dictionary (10th Edition, 1999) defines the adverb "mainly" to mean "*more than anything else*" or "*for the most part*", and primarily defines the adjective "main" to mean "*chief in size or importance*" (and similarly defines "principally" to mean *"for the most part; chiefly"* and "principal" to mean *"first in order of importance; main")*

5. Contrary to the Commissioner's suggestion (at paragraph 31 of the Issues Paper) that the ordinary meaning of "mainly" merely indicates "*something less than 100%*", in percentage

terms the most natural sense of the word “mainly”, reflecting its ordinary meaning of "*more than anything else*" or "*for the most part*", is simply *more than 50%*.

6. That is exactly the position that has been endorsed by New Zealand tax case law, namely *Commissioner of Inland Revenue v Mitchell* (1986) 8 NZTC (***Mitchell***) and *Newman Tours Limited v Commissioner of Inland Revenue* (1989) 11 NZTC 6,027 (***Newman Tours***). In addition, the adoption of the word "mainly", in place of the word "principally", in the relevant donee organisation provision as part of the rewrite of income tax legislation was specifically based on this case law authority.

Relevant New Zealand tax case law – *Mitchell* and *Newman Tours*

7. In *Molloy v Commissioner of Inland Revenue* [1981] 1 NZLR 688, the Court of Appeal (Somers J) discussed aspects of the relevant done organisation provision, as set out in section 84B(2)(a) of the Land and Income Tax Act 1954, and referred to *“the whole or the principal part”* of an organisation’s funds being applied to specified purposes within New Zealand. However, the Court did not discuss the *“wholly or principally”* requirement (as it then was), because the organisation at issue was *“confined entirely to New Zealand”,* nor have any subsequent cases dealt with this aspect of the particular provision.

8. However, *Mitchell* and *Newman Tours* directly addressed the meaning of the words *“wholly or principally”*, and “mainly” as a synonym for “principally”, in a tax context.

9. In *Mitchell*, the High Court (Davison CJ) had to decide whether a taxpayer's expenditure incurred in respect of the use of her home in connection with her employment as a teacher was deductible, under clause 7 of the 4th Schedule to the Income Tax Act 1976 (**ITA 1976**). This turned on whether or not the taxpayer's use of her dining room for work-related study meant that the room was used "wholly or principally" in connection with her employment.

10. The Court focused on the word "principally" and considered that word to be synonymous with "mainly", a word which the Court noted is "*an expression well understood by ordinary people*". The Court held that the term "mainly" means for the most part or more than half, and in doing so referred to Lord Morton of Henryton's comment that "mainly" probably means *"more than half"* in the House of Lords decision in *Fawcett Properties Limited v Buckingham County Council* [1961] AC 636, at 669, and also noted that this meaning is consistent with the dictionary definition of "mainly". The Court also specifically rejected submissions on behalf of the Commissioner that "principally", or "mainly", means substantially more than half or above 85%.

11. The Court concluded, and this was critical to the decision (not *obiter*, as suggested at paragraph 53 of the Issues Paper), that the test to be applied was whether the taxpayer's work-related use of her dining room was greater than the total of all other uses, taking into account not only the times taken up by the various uses of the room but also their frequency and their importance in an overall view.

12. In *Newman Tours*, the High Court (Eichelbaum J) referred to the *Mitchell* decision in the context of dealing with the issue of whether or not certain expenditure was tourist promotion expenditure incurred "*primarily and principally*" for the purpose of attracting tourists to New Zealand, under tourist promotion incentive provisions in the ITA 1976. The Court endorsed the *Mitchell* decision that "mainly" or "principally" means more than half, and then went on to note that under the relevant provisions the addition of "primarily" meant that the purpose at

issue must be not only the main one, in the sense of outweighing all other purposes (singly or collectively), but also the primary purpose, i.e. the first one.

Adoption of the word "mainly" as part of the rewrite process

13. Like the provisions at issue in *Mitchell* and *Newman Tours*, prior to the plain language rewrite of the income tax legislation the predecessor provision to section LD 3(2)(a) referred to an organisation's funds being applied "*wholly or principally*" to specified purposes within New Zealand. As part of the third stage of the rewrite process, which resulted in the introduction of the Income Tax Act 2004 (**ITA 2004**), the term "mainly" was substituted for "principally" in section KC 5(1)(aa).

14. In relation to this change, the November 2002 commentary on the Income Tax Bill noted as follows (at p41, and see also *Tax Information Bulletin*, Vol. 16, No. 5, June 2004, at p71):

> ***Using words in a consistent manner***
>
> *Some terminological changes have been made to ensure that words are used in a consistent manner. Examples are:*
>
> *…*
>
> - ***Mainly**. The rewritten provisions use mainly in place of primarily and principally and similar expressions. The expression primarily and principally was considered by Eichelbaum J in Newman Tours Limited v CIR (1989) 11 NZTC 6,027 (High Court). The Judge interpreted the expression as requiring that the purpose not only be the main one, in the sense of outweighing all other purposes, singly or collectively, but also the primary one, that is, the first one. Sufficiently similar connotations can be conveyed in the single word, mainly.*

15. It is also notable that these comments are made in the section of the commentary that focuses on *"plain language drafting"* (chapter 5 of the commentary). The section talks about drafting the legislation "*in the plainest possible way*" (at p37) and emphasises that plain language drafting "*uses words according to their ordinary meaning as far as possible*" (at p39).

16. This is consistent with the overall objective of the rewrite process, which was to make the income tax legislation clear, plainly expressed and easy to understand. This objective is of general importance, but may be seen as having particular importance for individuals and organisations, including charities and other not-for-profits, who may be less well-resourced. For example, the November 2002 commentary on the Income Tax Bill, referred to above, stated as follows (at p1):

> *"The key aim of the rewrite project is to produce tax legislation that is clear, uses plain language and is structurally consistent. Clear legislation makes an important contribution to increasing voluntary compliance with tax laws, because taxpayers can more easily identify and observe their income tax obligations."*

17. It would be inconsistent with this key aim of the rewrite, and also the specific legislative history in relation to the adoption of the word "mainly", for the words *"wholly or mainly"* to be given anything other than their ordinary and natural meaning.

Inland Revenue interpretation of "wholly or mainly" and "mainly" to date

18. Consistent with the word "mainly" in section LD 3(2)(a) being an alternative to "wholly" and having its ordinary and natural meaning, i.e. in percentage terms more than 50%, Inland Revenue has consistently interpreted and applied section LD 3(2)(a) in that way and affirmed that meaning of "mainly".

19. Examples especially familiar to charities and other donee organisations, and their advisors, include the following:

    (a) Inland Revenue's Operational Statement *OS 06/02 Interaction of tax and charities rules, covering tax exemption and donee status*, December 2006 (published on Inland Revenue's website, and in *Tax Information Bulletin* Vol. 18, No. 11, December 2006) discusses donee organisations and refers to the requirement (at that time under the ITA 2004) for an organisation to apply its funds *"wholly or principally"* to specified purposes within New Zealand. The statement says that "*where a charity applies a proportion of its funds overseas then Inland Revenue will need to consider whether overall the entity's funds are applied principally to charitable purposes within New Zealand*". It is clear that in this context Inland Revenue reads the phrase *"wholly or principally"* as setting out alternatives. In addition, it is clear that Inland Revenue reads the term "principally" (now "mainly") in its most natural sense, as more than 50%, as the statement then goes on to discuss government approval of an organisation for listing as a donee organisation for "*an organisation whose funds will be applied mainly overseas*". (Similarly, Inland Revenue's IR255 publication regarding charitable and donee organisations refers to listing being required for *"charities that apply the principal part or all of their funds outside New Zealand"*, at p27). This approach to donee organisation listing only makes sense if the word “mainly” has its ordinary and natural meaning of more than 50%.

    (b) Inland Revenue's current Public Ruling *BR Pub 09/03: Charitable organisations and fringe benefit tax*, applicable from the first day of the 2008/2009 income year, discusses the FBT exemption available to most donee organisations, under section CX 25(1) of the ITA 2007. Amongst other things, the ruling discusses whether or not a fringe benefit is received by an employee of a donee organisation "mainly" in connection with their employment in a business activity outside of the donee organisation's specified purposes. Prior to the rewrite of the income tax legislation, the FBT exemption used the words *"primarily and principally",* instead of "mainly". The commentary on the ruling refers to Lord Morton of Henryton's discussion of the word "mainly" meaning "more than half", the acceptance of that meaning by the High Court in *Mitchell*, the dictionary meanings of the terms "primarily" and "principally", and Inland Revenue's commentary on the change from "primarily and principally" to "mainly" as part of the rewrite, as noted above. In addition, in example 5 at the end of the ruling, Inland Revenue confirms that the FBT exemption would not apply to a low interest loan provided to an employee of a donee organisation, where such loans are available to all employees of the organisation, if the relevant employee is employed three days a week in a shop run by the organisation and two days a week in a food bank run by the organisation. Three out of five (60%) is enough for the employee to be viewed as receiving a benefit "mainly" in connection with his employment in non-charitable business activities of the organisation.

The Issues Paper does not identify compelling grounds for reinterpreting the "wholly or mainly" requirement under section LD 3(2)(a)

20. In light of the points set out above, there would need to be very clear and compelling grounds for departing from the ordinary and natural sense of the words used in section LD 3(2)(a), which is that "mainly" is an alternative to "wholly" and, in percentage terms, simply means more than 50%. The Issues Paper does not identify any such grounds.

Incorrect starting point regarding the ordinary meaning of "mainly"

21. Under the heading *What is the meaning of "wholly or mainly"?* (paragraphs 30 to 35), the Issues Paper discusses the "ordinary meaning" of the words used. As noted above, however, the starting point adopted by the Commissioner (at paragraphs 31 – 32 and also adopted earlier in the Issues Paper at paragraph 9) that the dictionary definition of "mainly" merely indicates "*something less than 100 percent*", so that the issue then becomes "*deciding the meaning of "mainly"*", is wrong. In percentage terms, the most natural sense of the word "mainly" is simply more than 50%, not something less than 100%. The issue is then whether there are any grounds to depart from the ordinary and natural meaning of the word.

Case law does not support departure from the ordinary and natural meaning of "mainly"

22. Under the heading *Case Law* (paragraphs 36 to 56), the Issues Paper discusses various cases and suggests they provide grounds for departing from the ordinary and natural meaning of the word "mainly" used in section LD 3(2)(a), based on its juxtaposition with "wholly". However, the cases cited do not provide such grounds:

    (a) First, in terms of New Zealand case law, *Mitchell* is referred to, but not *Newman Tours*, and *Mitchell* is inappropriately given no greater weight than overseas cases, despite the direct relevance of this New Zealand case law and the reference to this case law in adopting the word "mainly" in the donee organisation provisions, and other provisions, in the income tax legislation as part of the rewrite process.

    (b) Secondly, even if one were to set aside that specific legislative history, the weight of the case law referred to in the Issues Paper clearly supports the position that "mainly" (or "principally"), both on its own and as part of the phrase "wholly or mainly" (or an equivalent phrase), has its ordinary and natural meaning of "more than anything else" or "for the most part" - in percentage terms, more than 50%. The relevant case law referred to in the Issues Paper includes, most importantly, the key New Zealand tax case, *Mitchell*, and also two decisions of the House of Lords, *Imperial Chemical Industries plc v Colmer* [1999] BTC 440 and *Fawcett Properties Ltd v Buckingham County Council* [1961] AC 636 (referred to in *Mitchell*), and *Minister of Agriculture, Fisheries and Food v Mason* [1968] 3 All ER 76 (QB).

    (c) Thirdly, even if one were to set aside the above points, the other case law cited in the Issues Paper does not provide persuasive support for the preliminary view reached by the Commissioner:

        (i) *In re Hatschek's patents, ex p Zerenner* [1909] 2 Ch 68 is incorrectly interpreted by the Commissioner (at paragraphs 38 and 55 of the Issues Paper) as providing authority for the proposition that "mainly" means "*something significantly greater than 50 percent*". As the Issues Paper points out (at paragraph 38), the meaning of the word "mainly" did not need to be decided by the Court. In any

event, however, the Court recognised that “mainly” was an alternative to “exclusively” in the phrase *“exclusively or mainly”* and said that, in the particular legislative context, for manufacture to be “mainly” outside the UK the disparity between manufacture outside versus inside the UK would need to be “*greater than a mere small percentage*”. The example given by the Court to illustrate this point involved total manufacture of 2450, comprising 1200 (49%) within the UK and 1250 (51%) outside the UK, which the Court considered would not be sufficient for manufacture to be viewed as "mainly" outside the UK. The case therefore simply provides authority for the proposition that, in the particular legislative context, marginally more than 50% would not be enough to satisfy the “mainly” threshold. This does not support the Commissioner's preliminary view. For example, clear evidence of 55% manufacture outside the UK may well have been enough for the Court to accept that the "mainly" threshold was satisfied.

(ii) In *R v Radio Authority, ex p Bull* [1997] 2 All ER 561 (CA), the Court started from the position that a prohibition from radio advertising applicable to any body whose objects were “wholly or mainly” of a political nature would apply only if a body had objects of a political nature constituting *“more than half”* of its objects. The Court’s conclusion that, for the purposes of the particular prohibition, the threshold should be substantially more than half turned on the specific legislative context. The prohibition amounted to a substantial statutory interference with freedom of speech and communication, and for this reason the Court took the approach that the phrase *“wholly or mainly”* should be *“construed restrictively”,* and suggested that at least a 75% threshold would be appropriate in that context. The Court did not reject the view that “mainly” could mean simply more than 50% (as suggested at paragraph 40 of the Issues Paper). It rejected that meaning in the particular legislative context, a context which raised issues completely different from those that arise under section LD 3(2)(a), and required a "restrictive" interpretation.

(iii) *British Association of Leisure Parks, Piers & Attractions Ltd* [2011] TC 01504 is a UK First Tier Tribunal (**FTT**) decision in which the application of a VAT exemption for membership subscriptions paid to certain non-profit organisations turned, first and foremost, on the issue of whether or not lobbying was the Association's primary purpose. The FTT held that it was not, and dismissed the Association's appeal on that basis. The FTT went on to discuss, briefly and without reference to any authority, a secondary issue of whether or not the Association restricted its membership "wholly or mainly" to persons whose business or professional interests were directly connected with the Association's purpose, for which purpose the FTT assumed the Association's purpose to be lobbying. It was here that the FTT commented that, in the particular context, "wholly or mainly" would mean *"all or substantially all, eg 100% or a near percentage, rather than simply a bare majority"*. It is also notable that the FTT decision was appealed to the UK Upper Tribunal (**UT**) and although the *"wholly or mainly"* issue did not need to be addressed (because the UT dismissed the Association's appeal on the first issue), the UT was critical of various aspects of the FTT decision on the secondary issue (*British Association of Leisure Parks, Piers & Attractions Ltd v HMRC* [2013] UKUT 130).

23. In short, the only authority cited in the Issues Paper for reading “mainly” as requiring something substantially more than 50% is a case relating to a statutory interference with freedom of speech and communication (*Radio Authority*, and even in that case the Court only suggests a 75% threshold) and some *obiter* comments in a UK FTT decision, aspects of which were subsequently criticised by the UK UT (*British Association of Leisure Parks*). The weight of case law authority, and most importantly the New Zealand tax case law reflected in the rewrite of the donee organisation provisions, supports the position that “mainly" in section LD 3(2)(a) has its ordinary and natural meaning of *"more than anything else" or “for the most part”* – in percentage terms, more than 50%.

Legislative context and purpose, to the extent discernible, does not support departure from ordinary and natural meaning of "mainly"

24. Under the heading *Legislative context and purpose* (paragraphs 57 to 66), the Issues Paper discusses the phrase *“wholly or mainly”* in the context of the donee organisation provisions:

    (a) First, the Issues Paper inappropriately dismisses the relevance of the use of the word "mainly", and the phrase *"wholly or mainly",* elsewhere in the ITA 2007 (at paragraphs 57 and 66 of the Issues Paper). In light of the rewrite process and the deliberate adoption of the word "mainly" throughout the ITA 2007 (with reference to New Zealand tax case law), the Commissioner's position is misplaced and is inconsistent with the plain language drafting objectives of the rewrite. Absent compelling grounds to the contrary, the word "mainly" has its ordinary and natural meaning of "more than anything else"/"for the most part"/more than 50%, throughout the ITA 2007.

    (b) Secondly, the wording of section LD 3(2)(a), and indeed of section LD 3(2) as a whole, does not suggest that the words “wholly or mainly” should be given anything other than their ordinary and natural meaning. The different language that is used in relation to public institutions and ring-fenced funds in section LD 3(2)(c) and (d), requiring such institutions and funds to be “exclusively” for one or more specified purposes within New Zealand in order to qualify as donee organisations (as referred to at paragraphs 58 and 66 of the Issues Paper), is just that, different language.

    (c) Thirdly, the Issues Paper's attempt to identify a "theme" that tax incentives for gifts to donee organisations are intended to supplement government's social objectives for New Zealand society and are biased towards ensuring the benefits to New Zealand society (at paragraphs 59 to 62, and paragraph 66 of the Issues Paper), and to read down section LD 3(2)(a) on this basis, is, at best, strained. The October 2006 discussion document *Tax incentives for giving to charities and other non-profit organisations* referred to in the Issues Paper (at paragraphs 59 to 62) summarises in general terms Inland Revenue’s views regarding the rationales for tax incentives for charitable giving. Those rationales do not suggest that Parliament would not have contemplated tax incentives being available to organisations that apply their funds at least “mainly”, in its most natural sense, to specified purposes within New Zealand. A *“caring and cohesive society”* is not bound by borders. In addition, the principal legislative outcome that followed from the consultation process initiated by that discussion document was the lifting of the caps that previously applied to donors’ tax incentive claims for gifts to donee organisations. In that context, the prevailing criteria for donee organisation status were not called into question and Parliament saw no need to modify those criteria – notwithstanding that at the time, in light of the ordinary and natural meaning

of the words used in section LD 3(2)(a), New Zealand tax case law and the rewrite process, and also the established interpretation and application of the provisions by Inland Revenue, it was clear that an organisation qualifies as a donee organisation under the provision if it applies all or most of its funds, i.e. more than 50%, to specified purposes within New Zealand.

(d) Fourthly, there is also no wider "theme" in the income tax legislation (as suggested at paragraph 63 of the Issues Paper) in relation to limiting the availability of tax concessions to charities and other not-for-profits advancing their purposes within New Zealand. The Commissioner refers to the business income tax exemption for tax charities in section CW 42 of the ITA 2007, which does not apply to income apportioned to the pursuit of charitable purposes outside New Zealand. However, the Commissioner should also have noted that the non-business income tax exemption for tax charities does not include any such limitation. A tax charity pursuing purposes wholly or mainly outside New Zealand qualifies for the non-business income tax exemption. In addition, other general exemptions from income tax for not-for-profit entities in subpart CW of the ITA 2007 do not include any New Zealand purposes limitations.

(e) Fifthly, the same applies in relation to the listing of donee organisations in Schedule 32 (noted at paragraph 64 and 66 of the Issues Paper), which does not establish any such "theme". Schedule 32 listing is required to achieve donee organisation status when the criteria in section LD 3(2) are not met; it does not inform the interpretation of section LD 3(2). In addition, it is notable that Inland Revenue considers that such listing is required when an organisation has "*mainly overseas purposes*" (at paragraphs 64 and 123 of the Issues Paper) and has stated that listing is required for "*an organisation whose funds will be applied mainly overseas*" (as per Operational Statement OS 06/02, referred to above) and for *"charities that apply the principal part or all of their funds outside New Zealand"* (as per Inland Revenue's IR255 publication, referred to above).

25. Under the heading *Meaning of "wholly or mainly" in the context of s LD 3(2)(a)* (paragraphs 67 to 70), the Issues Paper summarises the Commissioner's conclusions and suggests that "mainly" should be read as *"something close to 100%" or "substantially all"*. Again, however, the analysis is flawed:

(a) First, the Commissioner suggests that the context of the legislation supports a view that "*access to tax advantages should be restricted as far as possible …*" and that Parliament only intended tax advantages to accrue for "*gifts to entities that apply their funds to specified purposes within New Zealand that then benefit New Zealand society*" (at paragraph 67 of the Issues Paper, and also later at paragraphs 117 and 127). For the reasons outlined above, such a view is not supported by the words used in section LD 3(2)(a) or the wider legislative context, and ignores the Supreme Court's position in *Stiassny* that "*the only evidence of … purpose is the detailed wording of the provision and the safest method is to read the words in their most natural sense".*

(b) Secondly, the Commissioner suggests that Parliament may have intended the word "mainly" (or "principally") merely to "*prevent minor or inconsequential applications of funds to non-qualifying purposes being a barrier to achieving donee organisation status*" (at paragraph 68). This is pure speculation, and is not supported by the words that Parliament has used, the wider legislative context or any relevant extrinsic materials. The ordinary and natural meaning of the word "mainly" (and previously, "principally")

used by Parliament indicates the clear intention that an organisation qualifies for donee organisation status so long as either all or most of its funds, i.e. at least more than 50%, are applied to specified purposes within New Zealand. If Parliament had intended to set a higher threshold for the application of funds to specified purposes within New Zealand, it could easily have done so.

(c) Thirdly, there are other relevant factors that may well have influenced Parliament being comfortable with an organisation qualifying for donee organisation status so long as either all or most of its funds i.e. more than 50% are applied to specified purposes within New Zealand. Such factors include the following:

(i) Until relatively recently, strict caps have always applied to tax incentives for gifts to donee organisations (most recently, a $630 cap on the tax credits that could be claimed by individual donors each year and a 5% of net income cap on the tax deductions that could be claimed by company donors each year).

(ii) As noted in the Issues Paper (and in *Molloy*, at 690 and 691), the "*within New Zealand*" requirement applies to all of an organisation's funds, not just the donations it receives, so there should be leeway for an organisation's funds to be applied other than for specified purposes within New Zealand.

(iii) In terms of providing such leeway, *"wholly or mainly"* (previously *"wholly or principally"*), read in its most natural sense of all or most, i.e. at least more than 50%, provides a relatively simple and practical test for organisations to comply with (subject to the note of caution sounded in *In re Hatschek's patents* that marginally more than 50%, e.g. 51%, might not be enough to satisfy a *"wholly or mainly"* requirement). In contrast uncertainties and impracticalities arise with the Commissioner's suggested reinterpretation of those words to mean without specification, "*something close to 100%*" or "*substantially all*".

Conclusion: "Wholly or mainly" means all or most, i.e. more than 50%, and there are no compelling grounds for reinterpreting those words

26. The Issues Paper does not identify any clear or compelling grounds for departing from the most natural sense of the words *"wholly or mainly"* used in section LD 3(2)(a), which is that "mainly" is a straight alternative to "wholly" and, in percentage terms, simply means more than 50%, not *"substantially all"* or *"close to 100%".* This position is consistent with the ordinary and natural meaning of the words used, New Zealand case law (binding on the Commissioner) regarding those words, and the legislative history (in terms of the rewrite process), and there is nothing in the context of the section or the wider legislation to warrant the reinterpretation suggested by the Commissioner.

27. If, as indicated by the Issues Paper, the Commissioner considers that the long-standing and well-settled interpretation and application of this aspect of section LD 3(2)(a) in accordance with its ordinary and natural meaning is not appropriate from a tax policy perspective, this should be dealt with through a legislative change made after completion of the generic tax policy process, not under the guise of reinterpreting the words used in the section.