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Exposure Draft PUB00295 Interpretation Statement IS 17/xx Income Tax: Donee organisations – meaning of wholly or mainly applying funds to specified purposes within New Zealand

Introduction

1. The New Zealand Law Society (**Law Society**) appreciates the opportunity to comment on *Exposure Draft PUB00295 Interpretation Statement IS 17/XX Income Tax: Donee Organisations – Meaning of wholly or mainly applying funds to specified purposes within New Zealand* (**draft Interpretation Statement**).
2. The Law Society supports the initiative to publish confirmation of the Commissioner's views in relation to the interpretation of section LD 3(2), and in particular section LD 3(2)(a), of the Income Tax Act 2007, but has a number of concerns in relation to the draft Interpretation Statement and in particular the 75% threshold proposed in it.
3. The Law Society's comments on key aspects of the Interpretation Statement are set out below. Unless stated otherwise, all statutory references are references to provisions of the Income Tax Act 2007 (**Act**) and case references are references to cases cited in the draft interpretation statement.

Comments

Background

4. *Issues Paper IRRUIP9 Donee organisations – clarifying when funds applied wholly or mainly to specified purposes within New Zealand* (**IRRUIP9**) set out the Commissioner's preliminary view that:
   a. the requirement under section LD 3(2)(a) that an organisation must apply its funds *"wholly or mainly"* to charitable or other specified purposes within New Zealand means that "*something close to 100%*" or "*substantially all*" of the organisation's funds must be applied to such purposes within New Zealand; and

b. an organisation would be treated as meeting the requirement only if 90% or more of its funds are applied to specified purposes within New Zealand.

5. The draft Interpretation Statement sets out the Commissioner's proposed, revised view that an organisation would be treated as meeting the *"wholly or mainly"* requirement only if 75% or more of its funds are applied to specified purposes within New Zealand, while also acknowledging that there a degree of flexibility and that an organisation's application of funds to specified purposes within New Zealand might fall below that threshold in a particular year without necessarily causing the organisation to breach the requirement.

6. The Law Society provided comments on the *"wholly or mainly"* requirement in response to IRRUIP9 in a submission dated 3 August 2016. The Law Society's previous submission set out in detail the Law Society's reasons for considering that *"mainly"* in the context of section LD 3(2)(a) is to be read as a straight alternative to *"wholly"* and means *"for the most part"* or *"more than anything else"*, i.e. more than 50%, not *"something close to 100%"*.

Summary of the Law Society's position – "wholly or mainly" means all or for the most part, i.e. more than 50%, not 75% or more

7. It appears that the draft Interpretation Statement has not fully taken into account a number of points that were made in the Law Society's previous submission on IRRUIP9. Therefore, the Law Society considers it appropriate for Inland Revenue to review the points made in that submission.

8. The Law Society's key concerns in relation to the draft Interpretation Statement are the same as its concerns in relation to IRRUIP9, namely that the Commissioner's preferred reading of "*wholly or mainly*", including the proposed 75% or more threshold, is incorrect as a matter of law and contradicts the long-standing and well-settled interpretation and application of this aspect of section LD 3(2)(a). Consequently, the Law Society considers that the statutory interpretation analysis in the draft item needs to be revisited and revised.

9. As set out in its previous submission, the Law Society considers that the correct statutory interpretation analysis leads to the conclusion that *"mainly"* is a straight alternative to *"wholly"* and means *"for the most part"* or *"more than anything else"*, ie more than 50%, not 75% or more (nor anything approaching such a threshold). The only potential gloss on this conclusion is that in order to meet the *"wholly or mainly"* requirement, the extent to which the application of funds to specified purposes within New Zealand exceeds 50% should not be marginal, e.g. 1%.

10. The Law Society considers that a higher percentage threshold such as 55% or 60% could, however, be adopted by the Commissioner for the purpose of providing a 'safe harbour' threshold for organisations to work with in relation to meeting the *"wholly or mainly"* requirement, i.e. a threshold that, if met, would mean that Inland Revenue will accept that the requirement is met (and if not met would mean that an organisation's position may be reviewed by Inland Revenue).

11. If an organisation applies 55% or more, or 60% or more, of its funds to specified purposes within New Zealand, it is clear that the organisation applies most of its funds for such purposes and that it is not close to the margins in relation to meeting the *"wholly or mainly"* requirement.

12. For completeness, the Law Society notes that if the Commissioner considers that a higher percentage threshold for the application of funds to specified purposes within New Zealand, such as 75% or more, should be imposed under section LD 3(2)(a), this would require legislative change and is a tax policy matter that should be pursued through the generic tax policy process.

Further comments on the draft Interpretation Statement's analysis of "wholly or mainly"

13. Further comments in relation to the draft Interpretation Statement's analysis of the meaning of "wholly or mainly" in section LD 3 (2)(a) are set out below. For ease of reference, the comments are set out under the headings used in the draft Interpretation Statement. These comments should be read in conjunction with the Law Society's previous submission on IRRUIP9 (attached as Annex A).

Introduction (paragraphs 16-20 of the draft Interpretation Statement)

14. The reference to section 5(1) of the Interpretation Act 1999 as a starting point for the statutory interpretation exercise, at paragraph 16 of the draft Interpretation Statement, is appropriate (see also section AA 3(2) of the Act). The Law Society considers, however, that the item should also refer to relevant and recent New Zealand Supreme Court guidance on the appropriate approach to statutory interpretation in New Zealand.

15. In particular, the Law Society considers that the following statement of the Supreme Court in *Stiassny v Commissioner of Inland Revenue*, at [23] (not [22], as suggested at paragraph 19 of the draft Interpretation Statement) per Blanchard J (delivering the unanimous decision of the Supreme Court), is of particular relevance in this context:

    "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. 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."

16. Although the Supreme Court's emphasis on reading the words of a provision "in their most natural sense" is referred to in passing at paragraph 20 of the draft Interpretation Statement, the full statement of the Supreme Court should be acknowledged and given appropriate weight in the Introduction.

The Text (paragraphs 21-60 of the draft Interpretation Statement)

17. In relation to the term "*mainly*", the draft Interpretation Statement suggests (at paragraph 26 and elsewhere) that the dictionary definition of the term merely "*indicates that something less than all of an entity's funds could be applied to specified purposes within New Zealand*" and that it is "*not a word with a single meaning*". The item also suggests (at paragraph 30 and elsewhere) that, with reference to case law, the term "*mainly*" "*does not have a single ordinary meaning*".

18. The Law Society considers that the approach taken in relation to the plain and ordinary meaning of the term "*mainly*" and the analysis of the case law in this section of the draft Interpretation Statement needs to be revisited.

19. In relation to identifying the plain and ordinary meaning of words used in a statute, as noted by the Supreme Court in *Commerce Commission v Fonterra Co-operative Group Ltd*, at [22] to [24] (cited at paragraph 18 of the draft Interpretation Statement), "*reference to*

recognised dictionaries is, of course, in accordance with the plain meaning approach", but "*the court having recourse to external resources*" (in that case, expert evidence and textbooks) is not.

20. The Supreme Court stated at [24], per Tipping J:

> *"If the court has to do that [ie, have recourse to external resources, other than recognised dictionaries] 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."*

21. With reference to recognised dictionaries, the plain and ordinary meaning of the term "*mainly*" (and also "*the most natural sense*" of the term, as referred to in *Stiassny*) is "*for the most part*" or "*more than anything else*", and in percentage terms more than 50%, not merely "*something less than all*". The Law Society notes, for example, the following dictionary definitions:

> "*for the most part; in the main; as the chief thing, chiefly, principally*"
> (Shorter Oxford English Dictionary on Historical Principles)
>
> "*more than anything else*" or "*for the most part*"
> (Oxford Concise English Dictionary)
>
> "*chiefly; principally; for the most part*"
> (Macquarie Dictionary)
>
> "*for the most part; to the greatest extent; principally*"
> (Collins Dictionary)

22. The case law cited in the draft Interpretation Statement, an external resource, does not support the position that the term "*mainly*" "*does not have a single ordinary meaning*". To the contrary, the case law reinforces the plain and ordinary meaning (and "*most natural sense*") of the term is "*for the most part*" or "*more than anything else*", and in percentage terms more than 50%. Where some other meaning has been adopted, this has been a *departure from* that plain and ordinary meaning, where the court has considered that the specific context clearly warranted such a departure:

    a. In the majority of cases cited, the courts have accepted that the plain and ordinary meaning of the term "*mainly*" is "*for the most part*" or "*more than anything else*", and have adopted that meaning, even in circumstances where "*mainly*" is used alongside and as an alternative to "*wholly*" in the relevant statutory provision, as part of the phrase "*wholly or mainly*". The relevant cases cited include *FH Faulding & Co Ltd, Fawcett Properties Ltd, Mitchell* (discussed further below), *Mason, Imperial Chemical Industries, Kenya Aid Programme,* and *On Call Interpreters*, and also *Franklin Gramophone*.

    b. In some of the cases cited, the courts have said that a bare majority, i.e. marginally more than 50%, would not be enough for a "*mainly*" requirement to be met. *Hatschek's Patents*, discussed further below and in the Law Society's previous submission on IRRUIP9, is an example of this. (Another example is *Davis*, where the court acknowledged that "*usually the word 'mainly' means 'more than half'*", at

paragraph 60, but went on to hold that in the specific context "*just greater than 50%*" would not be sufficient.) Such cases do not, however, provide support for reading "*mainly*" to mean something substantially more than 50%. Instead, they simply appear to put a gloss on the meaning of the term so that a "*mainly*" requirement may not be met if the threshold of more than 50% is only marginally exceeded (eg, by only 1%, as in the example provided by the court in *Hatschek's Patents*).

c. The cases cited where "*mainly*" has been read to mean something substantially more than 50%, e.g. "*75% or more*" (*Radio Authority*) or "*100% or a near percentage*" (*British Association of Leisure Parks)*, are outliers. As discussed further in the Law Society's previous submission on IRRUIP9, the courts in these cases opted to *depart from* the plain and ordinary meaning of the term "mainly" on account of the specific statutory context and the cases carry little weight.

23. In relation to the plain and ordinary meaning of the term "*mainly*", the Law Society also notes in particular the comments of the New Zealand High Court in *Mitchell* (cited at paragraph 44 of the draft Interpretation Statement). Davison CJ stated (at 5,183) that "*mainly... is an expression well understood by ordinary people*" and considered the *Fawcett Properties Ltd* assessment that "*'mainly' probably means 'more than half'*" to be consistent with the plain and ordinary meaning of the term as set out in the dictionary, i.e. "*for the most part, chiefly, principally*". It seems clear that the New Zealand High Court's view was that an ordinary person would understand the term "*mainly*" to mean, in percentage terms, more than 50%.

24. The Law Society is also concerned that the cases cited in the draft Interpretation Statement are not given appropriate weighting, and that the representation of some of the cases is inaccurate.

25. In relation to the weighting of cases, for the reasons set out in its previous submission on IRRUIP9, the Law Society considers that in a New Zealand tax context a court would give greater weight to the *Mitchell* case. This is reinforced by the fact that *Mitchell* informed the High Court's decision in *Newman Tours Ltd v Commissioner of Inland Revenue* (1989) 11 NZTC 6,027, which in turn was referred to in relation to the adoption of the term "mainly" throughout the Act as part of the rewrite process, and *Mitchell* has also informed the Commissioner's established administrative practice of reading "*mainly*" to mean more than 50% in the context of section LD 3(2)(a) and in other provisions (such as section CX 25, discussed further below).

26. In relation to ensuring that the case law is accurately represented, the Law Society notes, for example, the suggestion that *Hatschek's Patents* stands for the proposition that "*mainly*" means "*something significantly greater than 50%*" (eg, at paragraph 57 of the draft Interpretation Statement). This is misleading. As noted above and explained further in the Law Society's previous submission on IRRUIP9, the case simply suggests that a bare majority, i.e. marginally more than 50% (1% more in the example that was provided by the court), may not be enough to satisfy a "*mainly*" requirement. The case does not provide support for reading the term "*mainly*" to mean something substantially more than 50%.

Legislative context and purpose (paragraphs 61-94 of the draft Interpretation Statement)

27. The Law Society does not consider that the matters covered in this section of the draft Interpretation Statement provide any basis for departing from the plain and ordinary

meaning (and *"most natural sense"*) of the term *"mainly"* being *"for the most part"* or *"more than anything else"*, i.e. more than 50%.

28. Brief comments on the various matters covered in the section are set out below:

    a. Other paragraphs of section LD 3(2) (discussed at paragraphs 61 to 67) are of little relevance or assistance in interpreting the "wholly or mainly" requirement in section LD 3(2)(a). The other paragraphs simply use different terms (in particular, "exclusively"), and this appears to be a deliberate choice by Parliament. In relation to the Commissioner's observation that section LD 3(2) "shows some bias toward specified purposes being achieved in New Zealand" (at paragraph 67 and elsewhere), the observation adds nothing to the analysis. The plain and ordinary meaning of "wholly or mainly", i.e. all or for the most part, is also biased towards the achievement of specified purposes within New Zealand.

    b. The discussion of Part L (at paragraphs 68 to 72) adds little to the analysis.

    c. The discussion of Schedule 32 (at paragraphs 73 to 78) needs to be revisited. Schedule 32 listing is required where the statutory criteria set out in section LD 3(2) are not met, and the list of organisations in Schedule 32 and the listing criteria adopted by the government from time to time do not inform the interpretation of those statutory criteria. Of note, however, is the well-established administrative practice that Schedule 32 listing is required for an organisation to be a donee organisation if its funds are applied *"mainly"* to purposes overseas and that this is interpreted to mean for the most part or more than 50% (not a substantially higher threshold such as 75% or more). If *"mainly"* were not read in this way both in this context and in the context of section LD 3(2)(a), then there would be an unexplained gap in relation to an organisation that applies 25% to 49% of its funds to purposes overseas (based on the 75% threshold currently put forward by the Commissioner in the draft Interpretation Statement), i.e. the organisation apparently could not qualify as a donee organisation, either under section LD 3(2)(a) or by way of listing in Schedule 32. The more sensible reading is that Schedule 32 listing is made available to organisations that apply their funds *"mainly"*, i.e. for the most part or more than 50%, to purposes overseas (subject to other listing criteria being met), because it is in that circumstance (not a circumstance where 25% to 49% of funds are applied to purposes overseas) that donee organisation status will not be available under section LD 3(2)(a).

    d. The discussion of other uses of *"wholly or mainly"* in the Act (at paragraphs 79 to 82) inappropriately omits any reference to other uses of the term *"mainly"* in the Act. An example noted in the Law Society's previous submission on IRRUIP9, and well-known to many donee organisations, is the use of the term "*mainly*" in section CX 25, which provides a limited exemption from fringe benefit tax for most donee organisations. As noted in the previous submission, Inland Revenue confirmed in *Public Ruling BR Pub 09/03*, with reference to *Mitchell, Fawcett Properties Ltd* and the adoption of the term "*mainly*" throughout the Act as part of the rewrite process, that *"mainly"* is to be interpreted to mean for the most part or more than 50%, and the ruling included an example where 60% was sufficient to meet the *"mainly"* requirement. The same position is taken in Inland Revenue's very recent, replacement ruling regarding section CX 25 (see *Public Ruling BR Pub 17/06* and particular Example 5 at paragraphs 73 to 74.)

e. The discussion of the purpose of the Act (at paragraphs 83 and 84) should acknowledge the objective of the comprehensive rewrite of the income tax legislation discussed in the Law Society's previous submission on IRRUIP9, i.e. to produce tax legislation that is clear, uses plain language and is structurally consistent. This is especially important in this context given that the term "*mainly*" was deliberately adopted throughout the Act as part of the rewrite process.

f. The discussion of the legislative history of the tax incentive provisions for charitable giving (at paragraphs 85 to 94) is of limited value as it currently stands. The Law Society notes in particular the following points:

   i. References to broad statements regarding the intent of the incentive provisions made by politicians (at paragraphs 86 and 89 to 91) and by Inland Revenue (at paragraph 93) are of little, if any, assistance, because of their breadth and the fact that they do not address the "*wholly or mainly*" requirement (or "*wholly or principally*" requirement, under previous provisions) as adopted by Parliament.

   ii. The "*tax policy records*" and "*policy documents*" referred to at paragraph 87 are potentially of interest, as they appear to specifically refer to the "*wholly or mainly*" requirement ("*wholly or principally*" at that time) and seem to indicate that it was considered that a society would be viewed as meeting the requirement if "*say at least 2/3 of the Society's funds*" were applied for specified purposes. However, the identity and nature of these records/documents have not been disclosed, so it is not clear how much, if any, weight can be given to them. In addition, the most natural sense of the wording actually adopted, and subsequently re-enacted, in the relevant statutory provisions is all or most, not two-thirds or any other such threshold.

29. The Law Society also notes that neither this section of the draft Interpretation Statement nor any other section addresses the point that if Parliament had intended to set a higher threshold in relation to the application of funds to specified purposes within New Zealand, it could easily have done this but did not. In addition, there are various factors that may explain why Parliament was comfortable with an organisation qualifying as a donee organisation if it applies all or most of its funds, i.e. more than 50%, to specified purposes within New Zealand.

30. As noted in the Law Society's previous submission on IRRUIP9, this includes the following:

    a. Until relatively recently (prior to 1 April 2008), there were tight caps on the value of the tax incentives that could be claimed for monetary gifts to donee organisations.

    b. The "*wholly or mainly*" requirement under section LD 3(2)(a) and its predecessors applies to *all* of an organisation's funds, not just to the monetary gifts it receives, so there should be leeway for the totality of an organisation's funds to be applied other than for specified purposes within New Zealand.

    The higher threshold that the Commissioner is seeking to read into the "wholly or mainly" requirement gives rise to uncertainties and practical issues in relation to determining whether or not an organisation meets the threshold. Such issues do not arise, or are far less acute, if "*wholly or mainly*" is simply read as all or most, i.e. more than 50%.

31. Consequently, the Law Society considers that a number of aspects of legislative context and purpose point to "wholly or mainly" being read as all or most, i.e. more than 50%, and no basis has been provided for departing from that plain and ordinary meaning.

Monitoring compliance with the "wholly or mainly" requirement

32. The draft Interpretation Statement includes a discussion regarding monitoring compliance with the "wholly or mainly" requirement, with the Commissioner's suggested "75% or more" threshold in mind. The Commissioner has specifically asked for comment on the following:

    a. The requirement for organisations to monitor on an annual basis their compliance with a wholly or mainly threshold of 75%.

    b. The methods suggested for monitoring compliance.

    c. Any alternative monitoring methods.

33. Without derogating from the Law Society's view that *"wholly or mainly"* is to be read as all or most, i.e. more than 50% and not 75% or more, the Law Society comments on issues relating to monitoring compliance with the *"wholly or mainly"* requirement below. These issues may still arise, but would be far less acute, if a more than 50% threshold, or a 'safe harbour' threshold of 55% or more, or 60% or more, were to be applied.

Requirement for organisations to monitor compliance on an annual basis

34. The Law Society considers that self-monitoring compliance with the "wholly or mainly" requirement on an annual basis is consistent with other forms of compliance that donee organisations are typically required to undertake on an annual basis (e.g., annual return and financial reporting requirements under the Charities Act 2005, if applicable) and is appropriate as a starting point.

35. For practical purposes, it would be sensible for the annual period to be aligned with an organisation's annual financial reporting period, as indicated at paragraph 149, and further guidance should be provided in relation to acceptable methods for measuring compliance for such periods, as discussed further below.

36. The Law Society also agrees, however, that the "wholly or mainly" requirement under section LD 3(2)(a) requires an "overall determination", rather than being an annual requirement, so that any such annual self-monitoring of compliance with the requirement would be a starting point only. The historical application of an organisation's funds, and potentially also the prospective application of its funds, may be relevant to the overall determination.

37. This also means that the mere fact that annual monitoring indicates that an organisation has not, or will not, comply with the "wholly or mainly" requirement for a particular annual period does not necessarily mean that the organisation's donee organisation status is at risk, and this should be made clear by the Commissioner.

38. This is potentially important in relation to clarifying the implications for an organisation and donors in the event that it is determined that an organisation does not meet the "wholly or mainly" requirement, discussed further below.

Methods suggested for measuring compliance for an annual period

39. Two methods are put forward as to how organisations may measure compliance, at paragraph 150. It is suggested that an organisation may either:

    a. measure the ratio of funds from all sources spent in a year directly on achieving specified purposes within New Zealand as a percentage of all funds spent directly on achieving all of the organisations purposes for the year; or

    b. monitor compliance by taking into account the purposes for which funds are both spent and held, which may or may not include making apportionments on some reasonable basis of indirect expenditure and funds held for mixed purposes if this is critical to the overall assessment.

40. The Law Society notes that the second of these methods is more closely aligned with the Commissioner's approach to the meaning of funds being "applied" in the context of section LD 3(2)(a), at paragraph 139.

41. The guidance provided in paragraph 150 is too brief to be of assistance to donee organisations. The methods are not described in any detail, nor are they illustrated by any examples. The Law Society considers that in order to be of use to donee organisations, many of whom have limited resources, the methods for measuring compliance for an annual period prescribed or approved in the final item should:

    a. be as simple as possible, and are clearly and concisely described;

    b. be illustrated by one or more worked examples; and

    c. refer to, and to the extent possible be aligned with (e.g., in relation to terminology) and based on, the annual financial reporting requirements typically applicable to donee organisations (in particular, under the relevant tier for financial reporting purposes under the Charities Act 2005, if applicable).

42. At least for donee organisations that are registered under the Charities Act 2005, it should also be possible for the prescribed annual return forms (or online process) under that Act to be refined to incorporate such organisations' self-assessment of compliance with the "*wholly or mainly*" requirement for the relevant annual financial reporting period, including confirmation of the method used for measuring compliance.

Clarifying the implications for an organisation and donors in the event it is determined that the "*wholly or mainly*" requirement is not met

43. The draft Interpretation Statement does not adequately address the implications for an organisation and donors in the event that the organisation, or the Commissioner, determines that an organisation does not meet the *"wholly or mainly"* requirement.

44. An important aspect of this is that the annual monitoring and measurement of compliance contemplated in the draft item would only take place at the end of the relevant period, after donations have been received (and often spent) by the organisation and after donors have sought and received donation receipts from the organisation (and may have benefited from a tax credit or deduction) for their donations for the period.

45. It is important to reiterate, however, that, as noted above, the mere fact that annual monitoring and measurement of compliance indicates that an organisation has not, or will not, comply with the "*wholly or mainly*" requirement for a particular period does not necessarily mean that the organisation's donee organisation status is at risk.

    Nonetheless, the Law Society considers that the Commissioner should ensure that the final item addresses:

    a. an organisation's position in relation to being able, at least in the ordinary course, to issue donation receipts without having to delay until compliance with the "*wholly or mainly*" requirement has been assessed for the relevant period and to not have to claw back or cancel donation receipts that have already been issued prior to any determination that the requirement has not been met; and

    b. a donor's position in relation to being able, at least in the ordinary course, to rely on an organisation's inclusion on Inland Revenue's published list of approved donee organisations (accessible at http://www.ird.govt.nz/donee-organisations/), and to rely on donation receipts issued by such an organisation, prior to any determination, and publication or other notification, that the organisation is no longer considered to be a donee organisation or has not met the "*wholly or mainly*" requirement.

46. In relation to the latter point, the Law Society's previous submission on IRRUIP9 also suggested that it would seem appropriate for donors to have some protection in relation to claiming tax incentives for gifts to an organisation based on Inland Revenue approval/listing of the organisation at the time of their gifts.

Further information

47. 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

Annex A: New Zealand Law Society submission (3.8.16): *IRRUIP9: Donee organisations – clarifying when funds are applied wholly or mainly to specified purposes within New Zealand*

Annex A

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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

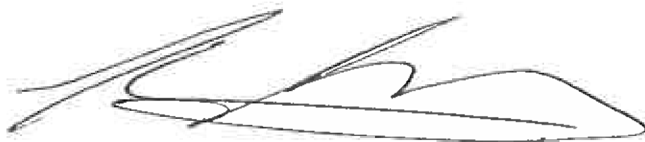
18. The Issues Paper touches on, but does not discuss in any detail, the implications of an organisation that is eligible for donee organisation status, or at least has been approved by Inland Revenue, becoming ineligible, or being found to be ineligible, for that status (e.g., on the basis that its 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

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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%, <u>not</u> 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.