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Tania Sauvao
Manager, Office of the Chief Tax Counsel
Inland Revenue Department
PO Box 2198
Wellington 6140

By email: tania.sauvao@ird.govt.nz

IS 18/Xx Income Tax: Donee Organisations – Meaning of Wholly or Mainly Applying Funds To Specified Purposes Fact Sheet

Introduction

1. Inland Revenue has prepared a draft Fact Sheet (**Fact Sheet**) to accompany the proposed Interpretation Statement *IS 18/xx income Tax: Donee organisations – meaning of wholly or mainly applying funds to specified purposes* (**Interpretation Statement**). The purpose of the Fact Sheet is to explain how organisations that qualify as donee organisations under section LD 3(2)(a) of the Income Tax Act 2007 (**Act**) can comply with the 75% “wholly or mainly” administrative safe harbour as set out in the Interpretation Statement.
2. Inland Revenue has specifically requested feedback around the method for monitoring compliance as set out in paragraphs 17 to 24 of the Fact Sheet together with any other comments the Law Society may have in relation to the Fact Sheet in general.

Comments

Background

3. *Interpretation Statement IS 18/XX Income Tax: Donee Organisations – Meaning of wholly or mainly applying funds to specified purposes within New Zealand* (**PUB00295**) stipulates that the Commissioner intends to adopt an administrative safe harbour for the purpose of determining if an organisation meets the “wholly or mainly” test in section LD 3(2)(a) of the Act.
4. A figure of 75% has been set as an administrative “safe harbour”, rather than being a figure that is set out in the legislation. Therefore, if an organisation spends or sets aside 75% or more of its total funds for specified purposes within New Zealand, the Commissioner (in her discretion) will consider that the organisation will qualify as a donee organisation, rather than the organisation qualifying for donee status by meeting a legislative threshold.¹

¹ The Law Society has previously made submissions in relation to the proposed threshold. It is the Law Society’s view that if the Commissioner intends to adopt a percentage threshold (in accordance with which an organisation would qualify for donee organisation status under section LD(3)(2)(a)) that threshold should be a legislation change rather than a policy change. (See paragraph 12, NZLS 30 November 2017)

Money spent or set aside to advance specified purposes within New Zealand

5. Paragraphs 8 to 16 of the Fact Sheet address the issue of how an organisation decides if money is spent or set aside to advance specified purposes in New Zealand. This requires a consideration of the purpose for the organisation's spending in the past income year and, where money had been set aside, determining the purpose for which it has been set aside at the end of the year.
6. It is stated at paragraph 15 of the Fact Sheet that if an organisation does have money that has not been spent or set aside for any identified purpose, that money is not considered as having been spent or set aside for specified purposes within New Zealand.
7. There are many organisations that have been established to support specified purposes in New Zealand but have the ability (should they resolve to do so) to support charitable objects outside of New Zealand. In many of these cases, the decision to support an overseas object may be driven by a request for funding or an awareness of a need that the organisation may, on being made aware of that need, determine to support. The organisation therefore may not know at the end of any given year what portion of funds it intends to utilise for support purposes outside New Zealand in the coming year. It may also be the case that funds used in one year to support an overseas object may not be allocated to that overseas object in the following year.
8. It is unclear why the Commissioner wishes to adopt a position that could result in donee organisations potentially not meeting the "wholly or mainly" test simply because they have not made an annual resolution as to how the balance of funds held by the organisation are to be utilised in the coming year.
9. The Law Society does not agree with the conclusion in paragraph 15 of the Fact Sheet. The Law Society considers that as a default position, any funds retained by a donee organisation at the end of any given year that have not been clearly allocated for a particular object or purpose should be deemed to be held for specified purposes within New Zealand, provided that the organisation's governing document (i.e. the organisation's trust deed, articles of association or constitution) supports that position.

The proposed method for monitoring compliance

10. Paragraphs 17 to 24 of the Fact Sheet provide suggested methods for an organisation to monitor its compliance.
11. The first step of the suggested method is for the organisation to determine its "total funds" by adding together all of the cash or cash equivalent amounts set aside at the end of the year and all of the amounts spent during the year.
12. The second step is for the organisation to determine the portion of funds applied to specified purposes within New Zealand by adding together:
 - a. the money wholly spent or set aside for specified purposes within New Zealand; and

- b. the proportion of money spent or set aside for a combination of independent purposes reasonably attributable to specified purposes within New Zealand.
13. The organisation then determines the percentage of the total funds that have been “wholly or mainly” applied for specified purposes in New Zealand by dividing that amount by the organisation’s total funds.
14. The difficulty with the proposed method relates to the point made in paragraph 6 above. That is, if an organisation has not determined a purpose for the funds it has set aside, those funds will not be counted as being part of the funds set aside for specified purposes in New Zealand but will be counted as part of the total funds of the organisation. Therefore, if an organisation has not specifically stated the purposes for which those unspent funds are held, they will be deemed not to be held for specified purposes in New Zealand.
15. This conclusion could lead to a number of organisations failing to reach the safe harbour ratio on the basis that even though the donee organisation is holding funds for the purpose or objects of the organisation (as recorded in the organisation’s governing document), if the organisation has not determined (by way of resolution or otherwise) the purposes for which those funds are held, they will be deemed to be holding those unallocated funds for purposes other than specified purposes within New Zealand. Such a conclusion is unlikely to reflect reality, particularly when viewed against the organisation’s governing document which more likely than not will record that the purposes or objects of the organisation are predominantly objects or purposes within New Zealand.
16. For the reasons specified in paragraph 9 above the Law Society does not support the Commissioner’s proposed approach.

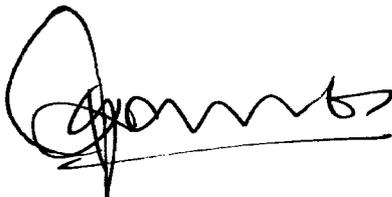
Examples

17. The Law Society considers that the examples given in the Fact Sheet are helpful and that it is appropriate to have examples in the Fact Sheet as well as the Interpretation Statement.
18. It would however be more helpful if Examples 1 to 18 were accompanied by examples of the annual calculations for the Foliage Foundation for the relevant years the examples are intending to cover.

Further information

19. This submission was prepared with assistance of the Law Society’s Tax Law Committee. If you wish to discuss this further, please contact the committee’s convenor Neil Russ, via the committee secretary, Jo Holland at jo.holland@lawsociety.org.nz, (04) 463 2967.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Tim Jones', with a horizontal line underneath it.

Tim Jones
Vice-President