Consultation on the tax treatment of mutual trading

1. Purpose of this consultation document

1.1. This consultation document is being issued to seek feedback from interested parties and stakeholders (including mutual organisations, their members, representatives of sectors affected and any other interested parties) on the preliminary findings of Revenue Jersey's review of mutual trading and the taxation of members' organisations / other mutual organisations.

1.2. Revenue Jersey is seeking feedback on its preliminary findings via specific questions but welcomes general comments on the issues covered in the consultation document.

1.3. The consultation is designed to ensure that the views of interested parties can be included within the final report which will outline any recommendations as to whether there should be legislative changes brought forward during 2019.

2. Background to Review

2.1. In Budget 2018 Senator Ozouf lodged an amendment (Draft Budget Statement 2018 (P.90/2017[1]): Seventh Amendment) proposing that:

2.1.1. a review should be made of the principle that the profits from mutual trading are not taxed; and
2.1.2. that legislation should be brought forward in Budget 2019 in order to tax the profits of mutual trading for the year of assessment 2019.

2.2. The Council of Ministers ("the COM") lodged comments to the amendment (Draft Budget Statement 2018 (P.90/2017): Seventh Amendment (P.90/2017 Amd.(7)) [2] – Comments). In their comments the COM:

2.2.1. supported the proposition to complete a review into the principle that the profits from mutual trading are not taxed; but
2.2.2. did not support bringing forward legislation in Budget 2019 as this pre-determined the outcome of the review.

[1] https://statesassembly.gov.je/assemblypropositions/2017/p.90-2017amd(7).pdf
[2] As above

2.3. The vote on Senator Ozouf's amendment was taken in two parts[3]. The States Assembly supported part 1) to undertake a review of the principle that the profits from mutual trading are not taxed, but rejected part 2) that legislation should be brought forward in Budget 2019.

2.4. The, then, Minister for Treasury and Resources committed to completing the review into the taxation of profits from mutual trading so that any legislative changes could be considered in the 2020 Budget (i.e. during 2019).

2.5. The purpose of this consultation is to gather evidence from interested parties in support of the review into the taxation of profits from mutual trading.

3. Background to the taxation of Mutual Trading/Members' Organisations

3.1. It is an established principle that no taxable profits arise, and hence no tax is payable, where persons trade with themselves. This principle is described in Simon Taxes (a leading U.K. tax reference material) as follows:

3.1.1. *If the persons carrying on a trade do so in such a way that they and the customers are the same persons, no profits or gains are yielded by the trade for tax purposes and therefore no assessment in respect of the trade can be made.*

3.2. The activities of an organisation trading with its members on a mutual basis has long been regarded in Jersey as a person trading with themselves for tax purposes and hence outside the scope of income tax.

3.3. There is no statutory definition of mutual trading within the Income Tax (Jersey) Law 1961 ("the Law"). Nevertheless the principle that no one can trade with themselves or make a profit out of themselves is well established by UK, and other common law jurisdictions', case law arising from over two centuries of mutual trading by organisations such as co-operative movements. Furthermore it is broadly accepted that such case law is persuasive in the context of taxation in Jersey, and Revenue Jersey expects the Courts in Jersey would follow these decisions.

3.4. There has been no attempt to overturn the principle in most jurisdictions Jersey looks toward. Where there has been a rejection of the strict approach, the alternative approach has been only to tax any 'surplus' retained by the organisation, leaving the majority of profits, which are returned to members outside of the organisation's tax position.

[3] https://statesassembly.gov.je/Pages/Votes.aspx?VotingId=4837

3.5. The common features of mutual trading are that the organisation must be trading directly with members, and that any surplus from such trading should be capable of being returned to members (in some form, at some time) in line with their contribution to the surplus.

3.6. Organisations which might be trading mutually with their members could include members clubs, societies, associations, co-operatives, etc.

3.7. Whilst there are many small members' organisations trading mutually, there are also large organisations which are involved in many of the sectors of the modern economy. The biggest case to be litigated on mutual trading in recent decades was in Australia being *Royal Automobile Club Victoria v Federal Commissioner of Taxation*, where the variety of activities which could be embraced by mutual trading, and the significant level of organisation involved, and the distinctions between what is mutual trading and what is not, was discussed.

4. Jersey's tax treatment of Mutual Trading / Members' Organisations

4.1. For the purposes of taxation in Jersey the receipts of a members' organisation from its mutual trading with members are not treated as "income" and accordingly the profits from such receipts are not taxable. It should also be noted that any expenses incurred by the member's organisation have to be allocated between mutual and non-mutual trading, and where, as can commonly occur, there is a loss from mutual trading, this loss cannot be set against the profits from non-mutual trading, or any other type of income received by the organisation.

4.2. For the avoidance of doubt, a members' organisation is taxable on:

4.2.1. any income the organisation receives from trading with non-members, or from trading in a non-mutual way with its members; and
4.2.2. any income the mutual organisation receives from land or investments (e.g. bank interest, dividends, rents etc.)

4.3. This consultation is focused on the income the members' organisation receives from trading with its members in a mutual way, which is outside of taxation in Jersey at present. Should these surpluses (or losses) also be subject to taxation?

4.4. The rate of tax members' organisations are chargeable to depends on their structures (i.e. as Jersey registered companies potentially at 0%, or at 20% as a person in their own right).

5. Common members' organisations: Clubs, societies and sporting associations:

5.1. Many clubs, societies and associations are not taxable on their subscriptions and members' fees etc., not because they are trading mutually, but from the fact that their activities are not considered 'trading'.

5.2. Trading can be fact specific, but if an activity is organised in the same way as a commercial organisation would organise, and endeavours to try and produce a surplus, it generally would be seen as trading. Most small members' organisations activities are not so commercially organised.

5.3. Members' organisations may have some small level of activities which are trading (e.g. selling advertising in a club newsletter). Whilst in strictness this income arising to a club, society or association from non-mutual trading is a taxable receipt, the Comptroller will ignore small amounts of trading with non-members in accordance with the published "Concession and practice: miscellaneous" M5 clubs, societies and associations[4].

5.4. Furthermore under this concession the Comptroller will not raise an assessment on the investment income of a club, society or association where the tax does not exceed £200.

6. Population of Members' Organisations in Jersey

6.1. There is no means of accurately assessing the full population of members' organisations which might be affected by a change of policy.

6.2. The company registry does not require members companies to be separately identified, or the extent to which they may or may not engage in mutual trading. There are also a number of members' organisations which are not registered under the Loi (1861) sur les Societes a Responsabilite Limitee or the Companies (Jersey) Law 1991. These are often registered under UK Law (which has been extended to Jersey) as some form of registered society. There will also be many members' organisations which although they may have constitutions and rules, are not on any register, and may at this time not be registered with Revenue Jersey.

6.3. To provide a baseline estimate, a review of the data held by Revenue Jersey, shows there are 173 live records whose names contain the words "mutual", "society", "association" or "club", suggesting they are members' organisations.

[4] https://www.gov.je/TaxesMoney/IncomeTax/Technical/ConcessionPractice/Pages/ConcessionPracticeMiscellaneous.aspx#anchor-3

6.4. A high level review indicates that these contain entities which Revenue Jersey would consider to be likely to be involved in mutual trading. However there are a significant number (approx. 50) entities which would probably be exempt from tax on the basis of their charitable status. The remainder of this group contains a number of organisations which in all likelihood are unlikely to be trading on any scale if at all, these include residents associations, small sports associations, hobby societies.

6.5. Revenue Jersey considers that there are circa 100 organisations which would require substantial additional interactions with Revenue Jersey from a policy change, albeit many may have no additional tax liabilities.

6.6. Revenue Jersey considers that the majority of Jersey resident individuals could be affected and estimates that more than three quarters are members of one or more of these organisations and the true extent may be much higher.

Question 1.

Are you answering this consultation on behalf of a members' organisation? If so, which organisation(s)?

Question 2.

Are you personally a member of a members' organisation? If so, which organisation(s)?

7. Revenue Impacts for Jersey - Taxation Revenues

7.1. Members' organisations can be constituted in a number of ways. In practice this will have a bearing on the taxation outcomes of a change in policy for the surpluses generated through mutual trading.

7.2. Members' organisations incorporated as companies are in the main taxable at 0%, as such there are no practical revenue impacts.

7.3. In terms of Large Corporate Retailers, at present no entities taxable under this legislation are engaged in mutual trading, and we have not identified any entities which would be brought into the scope of that measure by a change in policy.

7.4. Entities which are not 'companies' for the purposes of Jersey Tax Law, face potentially significant impacts. A number of entities would, if mutual trading was taxable, face additional tax liabilities calculated at 20%. The tax would be calculated by reference to their annual surpluses before any return of monies to members, which would then be taxed in the same way as general profits.

7.5. A review of the files of organisations which might be expected to have increased tax liabilities if there was a change to policy, suggests that even if: (i) there was no change in behaviour by those affected by the imposition of the tax, and (ii) the general economic outlook remains broadly stable, by using estimates which are at the higher end of the range, the additional tax which could be raised is unlikely to be exceed £1 million yearly and could be somewhat lower.

8. Impacts on Jersey Resident Individuals

8.1. There are two main potential impacts for individuals resident in Jersey.

8.2. If the surpluses of mutual trading are taxed, then any rebates or 'divis' from these members' organisations would be after tax, reducing the funds available to be returned to individuals. This would have a negative impact on the income of these individuals. Broadly, in the context of mutual trading in Jersey, these payments could be considered generally redistributive in nature as, unlike the investment income they are analogous to, they reach down to much lower income groups.

8.3. The cost of living may rise as any increase of the tax costs for these organisations may be passed on to their consumers, via price increases. This is not considered to be a highly likely outcome as competition from other companies and suppliers should mitigate any substantive impacts.

9. Potential Behavioural Impacts:

9.1. There is no certainty as to how, or if, tax changes will drive wider behaviours. This is particularly true where the current position is very long-standing; and where the alternative treatment is without comparable precedent in other jurisdictions.

9.2. However consideration should be given to these potential behavioural changes and the tax and other impacts, which could include the following.

9.3. A reduction in the number of members' organisations. For smaller organisations the record keeping and administration associated with being within the tax system, rather than any tax liability itself, may inhibit people from forming, or growing, members' organisations.

9.4. A reduction in the financial stability of members' organisations. Unlike general trading companies, members' organisations are not intent on making 'profits', rather on providing benefits for their members. However they are generally run on a conservative / prudent basis, to ensure they have enough funds to meet all eventualities, and then using the likely surplus to provide further benefits, or to return to members. If there is a pressure from the taxation of this surplus, they may seek to minimise their surpluses and hence the tax, and this could make them less stable entities, vulnerable to systemic or other shocks.

9.5. A move to restructuring of current members' organisations as companies under the Company (Jersey) Law 1991. This would for a number of entities reduce their tax rate to 0%. Whilst potentially feasible, in practice it would probably be an expensive exercise which would be conducted in public as these are generally democratic members' organisations, but would if adopted reduce the effective tax payable significantly (if not altogether), resulting in no additional tax revenues.

10. Options for amending the Tax Legislation:

10.1. There are two options to amend the tax legislation to ensure that the income from mutual trading is taxable.

10.2. The first is to tax the members' organisation on its 'surplus' from mutual trading.

Question 3.

If mutual trading surpluses (profits) were to be taxed, should this tax be levied on the members' organisation?

10.3. The second is to tax any mutual trading indirectly. This would be tax on the receipt of a discount / 'divi' etc. from a members' organisation in the members' income tax return.

10.4. The second option would create issues of administration for Revenue Jersey, given the large numbers of individuals who would be declaring this type of income (Revenue Jersey estimates at least three quarters of the Jersey population are members of an organisation which trades mutually), in addition there may be issues of identifying non-Jersey organisations where there are members residing in Jersey and their tax implications, and for lower income families this may affect their interactions with the Social Security System.

Question 4.

If the mutual trading surpluses (profits) were to be taxed, should this be on the members themselves?

Question 5.

If members are to be taxed on the 'divis' / distributions from members' organisations should they be entitled to a credit for any tax already paid by the members' organisations?

Question 6.

Does your answer to Question 5 depend on whether the tax was paid on mutual trading surpluses (profits) or non-mutual trading profits?

11. Other Approaches:

11.1. The principle of mutuality has been respected in most common law jurisdictions, including the U.K., Isle of Man, Republic of Ireland and Australia. The approaches in Guernsey and New Zealand differ to Jersey, this alternative approach goes further than the scope of the review envisioned by the States Assembly. However Revenue Jersey has considered this alternative approach as part of a rounded review.

11.2. This alternative approach, in summary, is to bring into tax all mutual receipts of any kind (both trading and non-trading), but to then allow as a deduction any return of the organisation's surplus to members (however that occurs).

11.3. Revenue Jersey cannot see any overall benefit of this approach to the majority of members' organisations, or tax revenues.

11.4. Impacts on members' organisations – whilst the alternative approach is easily understood, it will require all members' organisations to prepare tax computations. At present those members' organisations which can establish they only transact with members or do not trade, need only consider investment income, for most that simply means bank interest. Those with small non-member trading activities can usually rely on Concession M5, so again only need consider investment income. Overall the majority of members' organisations, and in particular the smaller organisations, would face increased administrative burdens from the alternative approach.

11.5. Impacts on tax revenues – the reviews by Revenue Jersey show that presently the largest members' organisations in Jersey, return the majority of their surpluses to members, including a significant portion which is generated from non-mutual trading and/or investment income. The impact of this change would be to allow these organisations to reduce their current tax liabilities.

11.6. Conversely there would likely be impacts on smaller organisations, particularly for those with limited capacity to borrow, who are 'saving' to purchase an asset (e.g. a sailing club may want to acquire a boat, or a football club, new changing rooms) by retaining a level of their surplus, which would under this alternative approach create tax liabilities.

11.7. Overall the view of Revenue Jersey is that an approach similar to New Zealand and Guernsey would lead to an overall reduction in tax revenues, but create tax liabilities on organisations that may be trying to develop in what would be seen as a beneficial way. The overall extent of revenue reduction has not been quantified because of the levels of data gathering required.

11.8. A major beneficiary under this approach would be Revenue Jersey, in that occasionally Revenue Jersey needs to enter into detailed dialogue with the largest members' organisations on the correct methodologies to reach their taxable non-mutual trading income, which this alternative approach would avoid.

Question 7.

Do you think that Jersey should follow the alternative approach as adopted in Guernsey and New Zealand?

12. Non Financial Implications of the Taxation of Mutual Trading:

12.1. Revenue Jersey is not in a position fully to estimate the wider impacts for Jersey's members' organisations. It is clear from the identified organisations that they are entwined in all sections and sectors of Island life, from professional associations, to the pursuit of cultural objectives such as organising parades, to showcasing Jersey to the rest of the world.

12.2. There are various publications which claim the benefits of different members' organisations to their local communities5. Examples include supporting local suppliers and businesses, tendency to provide higher staff wages, increased connections to wider democratic forums, engagement in community events, and addressing the lack of amenities outside of population centres. Given the high degree of involvement of Jersey's population with at least one members' organisation, we could expect that Jersey has benefited from some of these effects.

12.3. It seems clear a change of the policy around the taxation of mutual trading might have some level of negative impact on members' organisations, but the extent to which this could occur is not clear.

12.4. Revenue Jersey also cannot easily establish what if any impact these members' organisations have on other types of organisations and businesses. It is clear that many members' organisations are a response to the absence of other organisations, and therefore these organisations cannot be a direct competitor to other organisations. Yet in areas where these members' organisations are an alternative to

[5] https://www.nao.org.uk/successful-commissioning/introduction/what-are-civil-society-organisations-and-their-benefits-for-commissioners/ - https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31678/11-1401-guide-mutual-ownership-models.pdf - https://www.uk.coop/sites/default/files/uploads/attachments/impact_report_web_.pdf

other organisations, or in direct competition with other organisations, it is unclear that non-taxation of mutual profits is providing a substantial commercial advantage.

Question 8.

What are your views on the wider impacts of members' organisations on Jersey?

Question 9.

How important is the protection of these type of organisations to Jersey?

Question 10.

Do you think tax treatment and the associated administrative and compliance costs would significantly reduce the number and viability of these organisations?

Question 11.

Do you think the present tax rules on mutual trading are detrimental to other organisations or institutions? If so, in what respects?

Question 12.

Please provide your name, and any organisations or bodies you represent, in the context of this consultation.

Thank you for your time in reading this consultation. Completed questions for this consultation can be forwarded to Tax.policy@gov.je

Please mark your response: '*Consultation on the taxation of mutual trading*'

The consultation will close on the 17 May 2019.

Feedback on this consultation

We value your feedback on how well we consult or seek evidence. If you have any comments on the process of this consultation (as opposed to the issues raised) please email communications.unit@gov.je.

How we will use your information

The information you provide will be processed for the purpose of consultation. The Comptroller of Tax will use your information in accordance with the Data Protection (Jersey) Law 2018 and the Freedom of Information (Jersey) Law 2011. We may quote or publish responses to this consultation but we will not publish the names and addresses of individuals. If you do not want any of your response to be published, you should clearly mark it as confidential. Confidential responses will be included in any summary of statistical information received and views expressed.