

## Taxation of Mutual Trading/Members' Organisations

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### 1. Background

- 1.1. 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:

*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.*

- 1.2. 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.
- 1.3. 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', the case law arising from over two centuries of mutual trading by organisations such

as co-operative movements. This case law is persuasive in the context of taxation in Jersey, and Revenue Jersey expects the Courts in Jersey would follow these decisions.

- 1.4. The common features of mutual trading are that
  - 1.4.1. the organisation must be trading directly with members, and
  - 1.4.2. 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.
- 1.5. Organisations which might be trading mutually with their members could include members clubs, societies, associations, co-operatives, etc.

#### Is the organisation trading directly with members.

2. Who are members ?
  - 2.1. The members are the owners of the organisation. They will usually control the organisation.
  - 2.2. A mutual organisation can take a number of forms, some more formal than others, but there must be some form of constitution which establishes how the organisation is owned. It will also detail other rules which will ensure how it might meet the other requirements for mutual trading.
  - 2.3. Some mutual organisations may have subsidiary operations which trade with members. If the operations of these subsidiaries meet this guidance, and the income is treated in a manner consistent with this guidance, the fact it may have passed from one legal entity to another, and that the members are indirect owners, will not prevent it being treated as mutual trading income.

#### Example

Classic Car Owners Association has a retail operation which sells parts etc to its members, this is conducted through a wholly owned subsidiary company. The subsidiary pays dividends to the Association. The Association distributes surpluses to members, the surpluses include the income of the subsidiary, and the levels of

distribution take account of members trading with the subsidiary. Provided all the other criteria are met this will still be treated as mutual trading.

### 3. Trading income ?

- 3.1. Mutual trading only applies to trading income. In the context of the Law, this means that only income which would fall to be taxed under *Schedule D Case I – tax in respect of any trade carried on in Jersey or elsewhere*, can be considered in relation to Mutual Trading.
- 3.2. Mutual Trading can involve both goods and/or services, which may be similar to those offered by other commercial organisations.

Investment & interest income, income from land, are all outside of the scope of mutual trading.

### 4. Trading directly with Members ?

- 4.1. To form part of any mutual trade, the transactions must be directly between the organisation and a member.
- 4.2. It does not matter if the organisation is in the position of purchasing off a member or selling to a member. However commonly the organisation will be selling to a member.
- 4.3. The organisation must be operating as a principal, it cannot be acting as an agent for another organisation.

### Example

Mutual Ltd, offers insurance to its members.

If it writes its own insurance policies and the contract of insurance is between Mutual Ltd and its members, even if Mutual Ltd enters into a further agreement to reinsure the contracts it offers, this is capable of meeting the requirement of trading directly with members.

If Mutual Ltd instead offers the insurance products of others as an agent, where the contract for insurance is between the member and a third party insurance firm, were Mutual Ltd receives commissions even if it meets all the other requirements this would not be mutual trading.

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.

## 5. What is the surplus ?

- 5.1. Where an organisation engages in mutual trading, it is the sum which might be considered analogous to profit from these trades, in an ordinary commercial venture. In the context of mutual trading the members contribute to the organisation they own, and any monies it has left over are the contributions it did not require i.e. surpluses.

## 6. Capable of being returned to members

- 6.1. The constitution of the organisation should allow that any surpluses, both income receipts and potentially capital receipts, can be returned to members. Importantly it should not allow the surpluses to be returned to non members.
- 6.2. There should also be an expectation that this will happen, either as a 'dividend', a rebate on goods or services, reduction in fees etc. Although this does not mean there is a need to immediately distribute surpluses or that all surpluses of a period need to be distributed before it can be said to be mutual trading.
- 6.3. The members collectively should ultimately control how and when the funds are returned.

## 7. In line with their contribution to the surplus

- 7.1. Any return must be in line with the contribution to the surpluses, which means that the return is not linked to the level of ownership rather it is linked to the level of mutual trading undertaken by members.
- 7.2. If an organisation makes returns to members with whom it does not trade mutually or which are not linked to the level of mutual trading then it is unlikely that it would be considered to be conducting mutual trading.

- 7.3. The organisation must be able to quantify the level of contributions made by its members, this will generally be done by linking this to a membership number or account.
- 7.4. If an organisation offers certain services / goods on which it does not intend to return any surplus to members ( perhaps because they are operating on a low margin ) this would not form part of their mutual trading.

### Example

Mutual Retailer runs a large supermarket, and members are entitled to a return based on the level of goods they buy in the supermarket. There is also a petrol forecourt on the site, from which members also buy petrol. Mutual Retailer makes it clear that these purchases will not be included when there is a calculation of the level of return members receive. The petrol forecourt trade with members will not be mutual trading, whilst the supermarkets trade with members may be mutual trading.

- 7.5. Over time the membership of most organisations will change. Provided this is not an abrupt change but reflects normal circumstances this will not affect any consideration of whether the return of surpluses is in line with members' contributions.

### 8. Organisations which both have mutual trading and normal trading

- 8.1. Where an organisation has trading which may be mutual and trading which is either with non members, or with members but not on a mutual basis, care will need to be taken in identifying the part of the trading which is mutual, and how the surplus is quantified. There will also need to be apportionments of any allowances etc.
- 8.2. One of the more recent mutual trading cases to come before a court illustrates the complexity that might arise.

*Royal Automobile Club Victoria v Federal Commissioner of Taxation (1974)*  
*73 ATC 4153*

- 8.3. The case involved a substantial motoring club. The judge analysed 10 activities with varying conclusions as to if there was mutual trading. When looked at allocating expenditure to each activity, in particular the time spent by staff on each activity, he opined that "precision in not

possible". In the case the parties were asked to go away and reach a conclusion based on the detailed review of all the factors.

- 8.4. An organisation should consider approaching Revenue Jersey to agree a reasonable method to apply the principles in this guidance and calculate taxable profit, where they have a variety of activities.

## 9. Trivial Amounts of Tax – Concession M5.

- 9.1. Many organisations which may be involved in mutual trading may have small amounts of income from non mutual trading, for example occasional hire of the club's facilities for children's parties.
- 9.2. In such cases the concession M5 is available which ignores small profits, which are those which would not give rise to an assessable profit over £200.