Companies carrying on mutual business or not carrying on a business

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Introduction

This manual explains the concept of mutual trading and references caselaw and other useful information sources regarding Member's Clubs and Trade or Professional Associations.

This manual supersedes material in Tax Briefing No. 29 of December 1997.

1. Mutual Trading

The concept of mutual trading derives from the principle that an entity cannot trade with itself. Therefore, where classes of persons contribute to a common fund and have no dealings with any outside body, they cannot be said to have made a profit when they find they have overcharged themselves and that some portion of their contributions may be refunded. It may be that such transactions can amount to trading but any surplus resulting is not treated as a trading profit, on the basis of mutual trading.

Where there is a common identity between the contributors to the common fund and the participators in any surplus of that common fund, the contributors cannot be said to derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves.

This general principle equally applies to contributors who incorporate themselves into the separate entity of a company, even though any surplus contributions may be put to reserve and not immediately returned.
Conversely, if dealings take place with any outside body, profits from such activities would be liable to tax as the income is not derived from its mutual activities.

Case law – Mutual Trading

- New York Life Assurance Co. v Styles [1889] 2 TC 460
- Jones v The South-West Lancashire Coal Owners' Association Ltd. [1926] 11 T.C. 790
- Municipal Mutual Insurance Ltd. v Hills [1932] 16 TC 430
- Faulconbridge v National Employers' Mutual General Insurance Association, Ltd. [1952] 33 TC 103.

Case law – "Trading"

- Ransom v Higgs [1974] STC 539
- C.I.R. v Cornish Mutual Assurance Co. Ltd, 1926, 12 T.C. 84
- Liverpool Corn Trade Association Ltd. v Monks [1926] 10 TC 442
- IRC v Ayreshire Employers Mutual Insurance Association Ltd [1926] 27 TC 331.

As stated by Lord Wilberforce in Ransom v Higgs [1974] STC 539 "Trade involves, normally, the exchange of goods, or of services, for reward, not of all services, since some qualify as a

profession, or employment or vocation, but there must be something which the trade offers to provide by way of business. Trade moreover, presupposes a customer (to this too, there may be exceptions, but such is the norm), or, as it may be expressed, trade must be bilateral – you must trade with someone". The mutuality cases are based in part at least upon this principle.

Principles established from Case law:

- There must be a common identity between contributors to a common fund and participators in any surplus of the common fund, i.e. for trading to constitute mutual trading there has to be a common fund with complete identity between the contributors to the fund and the participators in it,
- Surplus must derive from business done with persons entitled to share in that surplus,
- Mutual concern established as a company is no less a mutual concern for being incorporated.

2. Non-Trading Companies

Companies of the following types are normally non-trading concerns outside the scope of Case I of Schedule D –

- Companies which conduct a members' club for social or recreational purposes,
- Ordinary trade or professional associations incorporated under the Companies Acts, being non-trading bodies formed to protect the common interests of members and deriving their funds from annual subscriptions etc. paid by members,
- Other bodies incorporated for non-trading objects, and deriving their funds wholly or mainly from members' subscriptions or from donations towards such objects.

The principles set out above apply equally in the case of management of apartments (including the management of holiday apartments).
One of the most important examples of the mutual trading principle in the income tax context is a members' club.

2.1 Members' Clubs

A members' club established for social or recreational objects is not carrying on a trade with its members, even if the club is incorporated (see C.I.R. v Eccentric Club Ltd., 1923, 12 T.C. 657), and is accordingly not liable to tax on surplus derived from members.
Thus, the surplus of the members' subscriptions over club expenses incurred is not a trading profit – the same conclusion applies to contributions made by members in exchange for goods and services provided by the club where the surplus forms part of the club funds (e.g. a members-only bar) [NALGO v Watkins 18 TC 499].
However, where goods and services are provided for a consideration to non-members, any surplus arising will be taxable. In the case of Carlisle & Silloth Golf Club v Smith [1913] 6 TC

198, Green Fees charged by a golf club to non-members were held to constitute taxable income.
While the mutuality principle can extend to cases where the group incorporates itself as a distinct legal entity, a company which trades only with its shareholders is not per se engaged in mutual trading (English v Scottish Joint Co-Op Society v Assam Agricultural ITC [1948] AC 405).
In Westbourne Supporters of Glentoran v Brennan [1995] STC (SCD) 137, an unincorporated members' club had two classes of members. Only members of one of the classes were entitled to vote and to serve on the club's management committee. The Special Commissioner observed that equality of voting rights was not a prerequisite of mutuality, although in some cases it might reflect a real difference between voting and non-voting members which would negate the existence of mutuality. Given the facts of the instant case, he held that there was in fact no such difference and that the 'mutuality' principle applied accordingly.
Incorporation with a share capital does not by itself involve liability as a trading concern. Additional factors should be taken into account such as:

- Where dividends are **not** paid, an incorporated company conducting a social or recreational club should normally be regarded as a members' club if –

  a) any share capital is all of one class, and every member (other than a person with restricted membership (see * below) is a shareholder, and

  b) the intention is that the members and shareholders shall be an identical body, and

  c) substantial identity exists in fact between members and shareholders.

Absence of complete identity between members and shareholders arising from the death, resignation or removal of former members may be ignored where substantial identity is maintained. Inequality of shareholdings is a factor for consideration in doubtful cases, but may in general be ignored so long as dividends are not paid.

- Where dividends **are** paid, liability as a trading concern should be considered to arise wherever the conditions in (a), (b) and (c) above are not satisfied. Liability may be inferred where there is marked inequality of shareholdings, and the dividends are substantial.

*The rules of a members' club (e.g. a members' golf club) frequently provide for the admittance of certain classes of person to restricted membership, such as juveniles admitted as "associate members", or members of similar clubs as "temporary members" or "visitors". Such circumstances are ordinarily considered to involve no liability (under Case I or Case IV) on a members' club, whether incorporated or not. No liability attaches to payments by members in respect of their guests, which may appear as "visitors' fees".

2.2 Distributions (Sections 130 – 135 and 436 TCA 1997)

Distributions made by a mutual trading company to its members in respect of their participation in the company's mutual activities are treated for the purposes of the Corporation Tax Acts and Schedule F relating to distributions as distributions in so far as they are made out of:

- profits (including capital gains) chargeable to corporation tax, and
- franked investment income.

Any other distribution (e.g. of a surplus arising on mutual trading) is not treated as a distribution for these purposes.
Claims for relief under section 396 TCA 1997, in respect of a loss on mutual trading, are not allowed.

2.3 Trade or Professional Associations

The associations in question are those incorporated under the Companies Acts, being non-trading bodies formed to protect the common interests of members and deriving their funds from annual subscriptions etc. paid by members.

The question as to whether a surplus arising is exempt from taxation in any case depends on whether, or not, a trade association or trade protection association, which may, or may not, be incorporated, is engaged in mutual trading. That question has been the subject of a considerable number of cases in the UK, principally involving insurance companies and societies, where the main issue was whether, or not, the profits of the insurance company or society were made from insuring its members. The question therefore was whether any surplus arising was derived from business done with the persons entitled to share in that surplus.

Income received from members in respect of mutual transactions is not liable to tax. Any expenditure related to such transactions is not tax deductible. A mutual trading concern is taxable in the ordinary way in respect of any income not derived from its mutual activities. Liability will therefore arise to a trade association under Case III of Schedule D in respect of its interest income, or under Case V in respect of any letting income. Liability under Case I of Schedule D could also arise. This would follow where the association has income or profits from any non-mutual activities, e.g. the provision of services to unconnected parties.

Arrangements with Revenue

A trade association may enter into an arrangement with the Revenue Commissioners under which it agrees to pay tax on surpluses arising from mutual trading with a view to ensuring that its members' subscriptions are allowable for tax purposes.
In the absence of any such arrangement, deductions for contributions are allowable to the extent only that the expenditure incurred by the association would have been tax deductible had it been incurred by the members themselves. Alternatively, where the function of the association is to provide specific services to its members, deductibility will

depend on the nature of the services provided. Entering into an arrangement with the Revenue secures that members' contributions are tax deductible in any event - see **Appendix A** for the conditions necessary as regard such arrangements.

No allowance is permissible in respect of expenditure of a political nature, although such expenditure may be within the objects of the association.

3. Other Information

Annual subscriptions paid by trade associations to a trade protection or other trade association -
These are allowable as a deduction only to the extent that they represent contributions towards expenditure incurred by the association on behalf of its members which if incurred by the members individually would have been allowable in arriving at their profits. Accordingly, subscriptions are not allowable insofar as they represent contributions towards:

- Expenditure by the association of a capital nature (e.g. the cost of erecting buildings)
  Or
- Expenditure by the association which if incurred by the members individually would not be allowable.

Contributions in the nature of premiums to an **insurance fund** maintained by a trade association are allowable, notwithstanding accumulation of the fund, provided the cover obtained is such that the premiums for obtaining it from an ordinary insurance company would have been allowable.
The above material has been incorporated from Tax Briefing No. 29 of December 1997.

Deduction of expenses for annual membership fees paid to Professional Bodies -
Please refer to Tax and Duty Manual Part 05-02-18 published on the Revenue website.

Further Queries

All queries regarding Mutual Trading status should be directed to the Revenue office of the relevant county. A full list of Contact Details is available on the Revenue website.

Appendix A

Arrangement with Revenue Commissioners (conditions)

Arrangements approved by the Revenue Commissioners under which members' contributions are deductible in computing profits for tax purposes

1. The Association shall furnish to the Revenue Commissioners copies of its Rules and Regulations and copies of any additions or amendments thereto as and when they are made.

2. The Association shall also furnish to the Revenue Commissioners a list containing the names and addresses of its members, and will advise of any additions thereto or deletions therefrom.

3. The Association shall render accounts of its income and expenditure and as hereinafter provided, shall be assessed to Corporation Tax by reference to section 76(1) [computation of income: application of income tax principles] and Part 41 (self-assessment) of the Taxes Consolidation Act, 1997, so far as the provisions of the aforementioned section or Part are not expressly excluded by or are not inconsistent with the terms of the Arrangement set out in this memorandum.

4. In computing the income assessable to Corporation Tax under Case I of Schedule D:

   (i) Receipts shall include all entrance fees, subscriptions, levies and other payments whatsoever (other than loans or payments of a capital nature) paid by members, and all other receipts of the association, other than income otherwise chargeable to corporation tax,

   and

   (ii) Expenditure will include all administrative expenses, all payments to members, of any kind, (other than loans and payments of a capital nature) and all payments for legal charges in cases taken on behalf of the members of the association.

5. Subject to the conditions hereinafter mentioned, for the purpose of computing the profits of Members of the Association for assessment to tax, payments (other than loans or payments of capital nature) made by the Members of the Association will be allowed to be deducted as a trade expense.

6. If any member has received, or will receive, from the association payment of any kind (other than loans or payments of a capital nature):

   (i) it will bring the amount received to the credit of its trading account and, for the purposes of computing its profits for assessment to tax, the amount will be treated as a trade receipt of the member for the period in which payment was or will be received;

   (ii) if a member neglects of refuses to bring the amount received to account, the amount will be disallowed as an expense of the association;

   (iii) the association will furnish immediately after the end of every period, particulars of all sums paid within the period to members, specifying the members to whom payments have been made and the amount of the payments.

7. Contributions or subscriptions by the association to any other organisation shall only be allowed as expenses on production of the accounts of such organisation and on evidence that it has entered in to similar arrangements with the Revenue Commissioners, or has no surplus income which ought, on the lines of these arrangements, to be subjected to tax.

8. The existing and future accumulated funds of the association will be regarded as taxed income in the event of the association being wound up and the funds distributed amongst the members.

9. The provisions of the Corporation Tax Acts except as specifically mentioned above, will not apply to any association entering into an arrangement.

10. In the event of any dispute as to the admissibility or non-admissibility of an item of expenditure, the matter will be dealt with by way of appeal to the Appeal Commissioners subject to the provisions of the Income Tax Acts (including the provisions relating to the statement of a case for the opinion of the High Court), on the understanding that these arrangements or the validity of the assessment made in accordance therewith shall not be otherwise impugned.

11. The association shall give an undertaking to abide by these arrangements.

12. These arrangements may be determined by the Revenue Commissioners or by the association on twelve months' notice expiring on the 31st December, in any year. They will be considered as terminated should the association not abide by them.

APPLICATION IS HEREBY MADE TO ADOPT THE ABOVE ARRANGEMENTS. WE, THE UNDERSIGNED, ON BEHALF OF THE ASSOCIATION, AGREE TO ABIDE BY THE TERMS AND CONDITIONS OF SAME.

Name of Association: _____

Address of Association: _____

_____

_____

Signed on behalf of the above-named Association by:

_____ Chairperson

_____ Secretary

Dated this day of