New Zealand Law Society
Te Kāhui Ture o Aotearoa

1 July 2025

Tax Technical
Inland Revenue Department

By email: public.consultation@ird.govt.nz

Tēnā koe,

ED0265: Mutual transactions of associations (including clubs and societies)

Introduction

1. The New Zealand Law Society Te Kāhui Ture o Aotearoa (**Law Society**) welcomes the opportunity to comment on Inland Revenue's (**IR**) draft operational statement: Mutual transactions of associations (including clubs and societies) (the **Draft Operational Statement**).

2. This submission has been prepared with input from the Law Society's Tax Law Committee.

Application of the common law mutuality principle

3. The Law Society does not agree with IR's view, expressed in the Draft Operational Statement, on the application of the common law mutuality principle to not-for-profit entities (**NFPs**).

4. IR's current view is premised on the wording of section CB 33 of the Income Tax Act 2007 (**ITA**), which provides that an amount derived by a mutual association that would be income but for the mutual character of that receipt is deemed to be income of the mutual association. IR's previous view was that the common law mutuality principle still applied to NFPs, as the statutory regime relating to mutual associations (originally section 145 of the Land and Income Tax Act 1954, then section 199 of the Income Tax Act 1976, and subsequently subpart HF of the Income Tax Act 1994) was necessarily restricted to mutual associations which were able, under their rules, to make distributions to members.[1] IR's previous view that the common law mutuality principle applies to NFPs is consistent with the Australian Tax Office's longstanding practice.

5. The Law Society agrees with IR's previous view on the application of the common law mutuality principle, and considers that the rewrite of the ITA (and, in particular, the adoption of the gross global basis of taxation) has obscured the fact that the statutory regime for the taxation of mutual associations was never intended to apply to NFPs. That said, the Law Society acknowledges that in *Case C27*,[2] which concerned the application of section 145 of the Land and Income Tax Act 1954 to a fishing co-operative registered under the Industrial and Provident Societies Act 1908, the Taxation Review Authority did not take

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1 The Law Society notes that many NFPSs are structured as incorporated societies, and the Incorporated Societies Act 2022 does not permit incorporated societies to make distributions to members, including on winding up.

2 (1978) 3 NZTC 60,861.

issue with the application of the mutuality provisions in the Land and Income Tax Act 1954 to income arising from the provision of services by the co-operative to its members, despite the fact that the rules of the fishing co-operative prevented distributions of surpluses to members, including on dissolution.

6. The Law Society considers it inequitable (and contrary to good tax policy) that mutual associations that are permitted, under their rules, to distribute profits to members in the form of rebates (which are deductible under section DV 19 of the Income Tax Act 2007) can achieve an outcome that is essentially the same as if the principle of mutuality applied (a point acknowledged in paragraphs 21 and 38 of the Draft Operational Statement), while NFPs that are not permitted to make distributions to members cannot.

Effect of the *Coleambally* decision on the application of the mutuality principle

7. The Law Society acknowledges that in *Coleambally Irrigation Co-operative Ltd v C of T*,[3] Hill J held that sinking fund levy contributions paid by members to a co-operative were taxable, even though they appeared to be of a mutual nature, because the co-operative's rules prohibited the distribution of any surplus or share capital to members (other than the nominal value of shares) on winding up, so there was no 'complete identity' between the contributors and the participants. The Law Society notes, however, that the *Coleambally* decision is at odds with *Case C27*, where the Taxation Review Authority applied the common law mutuality principle to levies paid by members of a fishing co-operative, notwithstanding that the rules of the co-operative prevented distributions of surpluses to members, including on dissolution.

8. The Draft Operational Statement takes the position (at paragraph 50) that the *Coleambally* decision would be followed in New Zealand and, as a result, subscriptions and levies, which might not otherwise be treated as income under section CB 33 of the Income Tax Act 2007, cannot benefit from the common law mutuality principle where the rules of the association prevent the association from making distributions to members. The Law Society does not agree that this would necessarily be the case, given that in *Case C27* the Taxation Review Authority did not consider that the prohibition, in the co-operative's rules, on distributing surpluses to members (including on dissolution) precluded the application of the common law mutuality principle to subscriptions and levies paid by members.

9. The Law Society notes that, to ensure NFPs were not disadvantaged by the *Coleambally* decision in Australia, the Australian parliament enacted section 59.35 of the Income Tax Assessment Act 1997. Under section 59.35, ordinary income is treated as non-assessable non-exempt income if it would have been a mutual receipt but for the entity's governing documents preventing the entity from making distributions to its members. Section 59.35 applies retrospectively to income years commencing after 30 June 2000.

10. The Law Society considers that to ensure that NFPs are not disadvantaged by the *Coleambally* decision in New Zealand (if the New Zealand courts were to follow that decision, rather than the Taxation Review Authority's decision in *Case C27*), a similar amendment should be made to the ITA.

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3 [2004] FCA 2.

Compliance costs arising from IR's approach to the mutuality principle

11. The Law Society is concerned about the compliance costs arising from IR's approach to the mutuality principle, particularly for NFPs that are unable to make distributions to members.

12. For example, in determining whether subscriptions and levies paid to such NFPs are subject to income tax, NFPs are required to consider whether such amounts are business income (and, therefore, income under section CB 1(1) of the ITA) or income under ordinary concepts (and, therefore, income under section CA 1(2) of the ITA). Determining whether subscriptions and levies are income under ordinary concepts requires the consideration of a number of factors and the exercise of a high level of tax expertise and judgement. To that end, paragraph 52 of the Draft Operational Statement notes as follows:

> Whether amounts are income under ordinary concepts depends on all the circumstances of the association in question relevant to characterising particular receipts as income and determining their quality in the hands of the recipient. Factors such as the regular, recurrent or periodic nature of payments may indicate the payments have become part of the receipts on which the recipient relies to meet expenses for continued operation. The arrangements between the association and its members, the intent or purpose of payments made, and what is expected of the association in return for the payments are also matters to consider in determining their quality in the hands of the association.

13. The Law Society is concerned that NFPs may lack the inhouse expertise to accurately determine whether subscriptions and levies are business income or income under ordinary concepts, and will not be in a position to pay for professional advice to consider this point. This is likely to give rise to widespread non-compliance, contrary to the outcome that IR is endeavouring to achieve by publishing its position on the application of the mutuality principle to NFPs.

14. For this reason, the Law Society considers it would be preferable to enact a provision which precludes the possible application of the *Coleambally* decision in New Zealand, so NFPs that cannot make distributions to members can still apply the mutuality principle to receipts (such as subscriptions and levies) that are not subject to subpart HE of the ITA and, therefore, not deemed to be income under section CB 33 of the ITA. The Law Society notes this is consistent with IR's previous view, as expressed in IR 9G, "Clubs or societies return guide 2025".

Recommendations

15. As above, the Law Society recommends a statutory provision is enacted to preclude the possible application of *Coleambally* in New Zealand, so NFPs that cannot make distributions to members can still apply the mutuality principle to subscriptions and levies, and do not have to incur unnecessary compliance costs in determining whether such amounts would otherwise be business income or income under ordinary concepts.

16. The Law Society also recommends that consideration is given to enacting a specific income tax exemption for NFPs, which would treat all income of a mutual character derived by NFPs as exempt income. The Law Society notes this is consistent with the position that currently applies to NFPs in Australia. This income tax exemption would expressly override sections CB 33 and CB 34 of the ITA and could be modelled on the income tax exemption that currently applies to friendly societies in section CW 44 of the ITA. If the taxation of NFPs is

addressed in this manner, it would not be necessary to enact a specific statutory provision to preclude the possible application of *Coleambally* in New Zealand. Further, it would no longer be necessary to retain the specific income tax exemption for friendly societies, which would enhance horizontal equity in the tax system.

17. The Law Society notes that even if such an income tax exemption were enacted, small NFPs that do not carry on transactions outside their circle of membership but derive a modest amount of investment income will still be required to file income tax returns, even though the maximum deduction permitted under section DV 8 of the ITA will mean that the NFP will not be required to pay income tax. The Law Society recommends IR consider exempting NFPs from filing income tax returns where an NFP's income (after excluding transactions of a mutual character) is less than the maximum deduction permitted under section DV 8 of the ITA. The Law Society refers to paragraph 52 of its submission on IR officials' paper,[4] "Taxation and the Not-for-Profit-Sector," that the income tax deduction allowed under section DV 8 of the ITA should be increased to at least $5,000 (although an increase to somewhere between $6,500 to $7,000 would be required to keep pace with inflation since that threshold was last increased in 1979). Exempting NFPs from filing income tax returns where the NFP's income (after excluding transactions of a mutual character) is less than the maximum deduction permitted under section DV 8 of the ITA, coupled with an increase in the amount of that deduction to a more meaningful figure, would minimise compliance costs both for NFPs and IR.

18. The Law Society acknowledges that exempting small NFPs who derive only a modest amount of taxable income from filing income tax returns will result in IR having limited data to monitor such entities. However, that outcome is likely to reflect the current state of affairs, in that the Law Society understands many small NFPs do not currently file income tax returns under the mistaken belief they are not currently required to do so.

Further comment

19. Should you wish to discuss any aspect of this feedback, please contact Aimee Bryant, Manager Law Reform and Advocacy (aimee.bryant@lawsociety.org.nz).

Nāku noa, nā

David Campbell
Vice President

[4] 31 March 2025, https://www.lawsociety.org.nz/assets/Law-Reform-Submissions/IR-Charities-and-NFP-31-March-2025.pdf