



The Taxation Office view on this arrangement is set out in TR 2004/5.

FOI status: may be released

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging tax planning issues or arrangements that the ATO has under risk assessment.

Taxpayer Alerts will provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform ATO officers of new and emerging tax planning issues. Not all potential tax planning issues that the ATO has under risk assessment will be the subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the ATO.

Taxpayer Alerts will give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and will highlight the features which the ATO considers give rise to taxation issues. These issues will generally require more detailed analysis to provide an ATO view to taxpayers.

The developers and marketers of an arrangement which is the subject of a Taxpayer Alert should provide the full facts of the arrangement to the ATO to enable the ATO to finalise its view.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the ATO's position through a Private Ruling. Such taxpayers might obtain their own advice and/or contact the ATO officer named in the Alert.

This Taxpayer Alert is issued under the authority of the Commissioner.

TITLE: Mutual associations - deductibility of contributions and derivation of income (volume allowances)

This Taxpayer Alert describes an arrangement where a retailer directs money received by way of volume allowances (or rebates) receivable from a wholesaler to a company said to be a mutual association. The retailer then claims deductions for the redirected volume allowances as contributions. The contributions are in excess of the expenditure incurred by the mutual association, and it is said the surplus can be returned to the members tax free.

DESCRIPTION

The alert applies to arrangements having the following features:

1. The establishment of a company said to be a mutual association with retailers as members.
2. The mutual association (a 'banner company') carries out marketing, advertising, merchandising and negotiates volume allowances on behalf of the retailers.

3. The company is said to not be a co-operative covered by Division 9 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936).
4. The payment of monthly member contributions by the retailers to the company.
5. The redirection of volume allowances derived by the retailers so that they are paid directly from the wholesaler to the company as additional contributions by the retailers.
6. The return of surpluses of contributions over the company's expenditure to the retailer, in proportion to the volume allowance attributable to the retailer, on a regular basis.
7. The arrangements are typically marketed as a 'tax free income' scheme.
8. The arrangement differs from most *bona fide* mutual arrangements, because of the regular distributions of surpluses to members and the lack of parity between the contributions of members and the company's anticipated expenditure.

The ATO has previously issued favourable private binding rulings in respect of one arrangement having these features. However, following a recent high level review of these kinds of arrangements, the ATO considers that they have taxation features that are questionable. That review is the source of this alert.

This alert does not disturb different arrangements involving mutual associations that the ATO has previously ruled on in private or public rulings.

FEATURES WHICH THE ATO CONSIDERS GIVE RISE TO TAXATION ISSUES

- (a) The arrangement raises issues about whether the purported mutual association is in fact a mutual association. The company may be carrying on business of trading with its members. If so, the amounts received by the purported mutual association are derived by it as assessable income. This raises questions about the application of Division 9 of Part III of the ITAA 1936 to the company.
- (b) The arrangement is said to give the retailers a deduction for their contributions, including the redirected volume allowances, to the purported mutual association. There are questions about the deductibility of payments to a mutual association, under in particular section 8-1 of the ITAA 1997. The mutuality principle established that one cannot make a profit out of themselves. This raises the question as to whether one can make a loss from themselves.
- (c) The arrangement is said to have the effect that distributions by the purported mutual association are not assessable income of the members to whom it is distributed. However, the distributions may be dividends to which section 44 of the ITAA 1936 applies, or otherwise assessable income.
- (d) The retailers derive the volume allowances as assessable income.
- (e) The arrangement raises questions about the application of the anti-avoidance provisions of Part IVA of the ITAA 1936.

The Australian Taxation Office is examining these arrangements.

subject references: Mutual entities, derivation of income, deductibility of payments to mutual entities.

related taxation rulings:

legislative references: ITAA 1997 Section 8-1
ITAA 1936 Division 9 of Part III
ITAA 1936 Part IVA
ITAA 1936 Section 44

related taxpayer alerts:

related practice statements: PS 2001/15 - Taxpayer Alerts

related media releases:

file references: 2002/0011769; 2002/0012351

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