TR 93/39 - Income tax: friendly society education funds

Taxation Ruling
Income tax: friendly society education funds

*This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Ruling is about

1. This Ruling is concerned with the tax consequences of education funds offered by some friendly societies. In particular, it is concerned with the questions whether the societies offering such funds qualify for exemption from income tax under subparagraph 23(g)(i) *Income Tax Assessment Act 1936*, and whether payments from such funds qualify for exemption from income tax under paragraph 23(z).

Ruling

Subparagraph 23(g)(i)

2. In the cases considered in this Ruling, the income of a friendly society offering an education fund is not exempt under subparagraph 23(g)(i), as the education fund is carried on for the purposes of profit or gain to individual members of the society. No income of the society, including income relating to the education fund, is exempt.

Paragraph 23(z)

3. In the cases considered in this Ruling, where a friendly society education fund pays education costs to or for the benefit of a student undertaking full-time education at a school, college or university, a payment that is in income form will not be exempt from tax under paragraph 23(z) because it is not a scholarship, bursary or other educational allowance or educational assistance.

Date of effect

4. This Ruling has both a past and future application (see Taxation Ruling TR 92/20). However, it does not have a past application for any friendly society that had previously sought and received an advance opinion that granted exemption to the society under subparagraph 23(g)(i) in respect of an education fund and to payments from the fund under paragraph 23(z).

5. It may also not have a past application to some other friendly societies if other exceptions to the general rule, as outlined in the guidelines set out in Taxation Ruling TR 92/20, are satisfied.

6. In those cases where there is no past application, exemption under subparagraph 23(g)(i) will continue but only in respect of contributions actually paid before 29 April 1993 (or paid after that date pursuant to a legally binding obligation entered into before that date). The paragraph 23(z) exemption will continue to apply to payments made from a fund comprising those contributions and any net income accumulated on them.

7. The subparagraph 23(g)(i) exemption will continue to apply to net income accumulated on contributions specified in paragraph 6 unless the society accepts new contributions after 29 April 1993. Consistent with the approach indicated in paragraph 2 of this Ruling, acceptance of new contributions will produce the result that exemption of the society's total income will cease from the date of acceptance.

Explanations

Facts

8. Education funds are established by some friendly societies. The funds vary between societies, but in cases considered recently have some common features. For example,

- contributions are made by a member (whether in a single lump sum or by instalments);
- funds are accumulated from investment of the contributions (after deduction of management charges);
- payments from those funds provide benefits in relation to the education of a student (or students) usually nominated by the member; and
- benefits provided are usually limited to the funds accumulated in relation to the member's contributions.

9. Typically, any of the following may occur in relation to such an education fund:

(a) a separate account will be maintained in the books of the fund in the name of the member in which the member's contribution will be placed;

(b) there will be ascertainable interest, identifiable as accruing to the member's contribution(s);

(c) a periodic statement will be available about the state of a member's account, including details of accrued interest, charges or fees deducted and payments to or for a nominated student; and

(d) payments may be made to a person nominated by the member, who has capacity to change the nomination.

10. Because of the current requirements of legislation under which friendly societies are registered, the nominated student must be either a dependant of the member or must be related to the member. That does not mean that the member must be under a legal obligation to pay for the student's education, or even that the member has assumed a voluntary obligation to pay (apart from the voluntary obligation constituted by the member's nomination to the fund).

11. Some funds permit the member to recover or withdraw all or part of the contributions made. Others permit the member, or the member's estate, to receive part of the funds accumulated from the member's contributions. The member may be required to specify the eligible student or students initially, or later, and may be allowed to change the nomination. In some cases, the member is required to nominate the particular institution at which the student will study and the date from which benefits are expected to be provided.

Opposing views

12. It is claimed by the friendly societies concerned that -

(a) there is no purpose of profit or gain to the individual members from an education fund and therefore the friendly society is exempt under subparagraph 23(g)(i); and

(b) the payment from the fund is income derived by way of scholarship, bursary or other educational allowance or educational assistance such as to satisfy, in the hands of the student, the exemption provided by paragraph 23(z); alternatively, the payments do not constitute income.

13. In the Commissioner's view -

(a) there is a purpose of profit or gain to the individual members; this is so whether the gain is of an income or capital nature or a combination of income and capital, or indirect in character; and is so even if profit or gain does not accrue immediately or to a particular member. So the society will not be entitled to the exemption; and

(b) income payments from a fund set up to pay the education expenses of a specified institution and for a specified student do not have the necessary character to satisfy the requirements of paragraph 23(z).

Paragraph 23(g)(i) - Exemption of Friendly Society

14. Paragraph 23(g)(i) provides:

'23. The following income shall be exempt from income tax:-

(g) the income of a society, association or club which is not carried on for the purposes of profit or gain to its individual members and is:

(i) a friendly society, not being a friendly society dispensary;'.

15. A friendly society is a society duly registered as a friendly society under Commonwealth, State or Territory legislation. Whether a society is so registered is a question of fact.

16. A friendly society is exempt only if it is not carried on for the purposes of profit or gain to its individual members. If such a society is carried on to any extent for the purpose of profit or gain to any individual members, even if there are aspects of its conduct that are not for profit or gain or not for individual members, none of its income is exempt from income tax.

17. Friendly societies have traditionally provided benefits to particular members. Typical benefits related to sickness, unemployment, need or death. Financial benefits were provided to members who had contributed to the relevant fund and whose circumstances qualified them for the particular form of relief. So there has always been an element of personal benefit in the activities of friendly societies.

What is a profit or gain?

18. A profit or gain includes any benefit, direct or indirect, pecuniary or non-pecuniary, capital or revenue, that any person may obtain. 'Gain is something obtained or acquired. It is not limited to

pecuniary gain. We should have to add the word "pecuniary" so to limit it. ...
[It] is not "gains", but "gain", in the singular. Commercial profits, no doubt, are gain; but I cannot find anything limiting gain simply to a commercial profit.' (Jessel MR in *in re Arthur Average Association* (1875) LR 10 Ch App 545, at n546-547) A diminution of loss is a gain, and so mutual commercial insurance involves a gain (*re Padstow Total Loss and Collision Insurance Association* (1882) 20 Ch D 137), and a gain may be derived indirectly, not merely directly, and includes any benefit, profit or advantage (*R v. James* (1903) 6 OLR 35, at 38; *Stanger v. Hendon Borough Council* [1948] 1 KB 571; *re Southside Plaza Merchants' Association* [1965] NSWR 1454; *in re Riverton Sheep Dip* [1943] SASR 344; *re Commonwealth Homes and Investment Co Ltd* [1943] SASR 211).

19. These formulations of the scope of profit and gain are wide. If every profit or gain precluded exemption under subparagraph 23(g)(i), a friendly society could hardly conduct any activity for its membership and be exempt. That view influenced Stephen J in *Australian Dental Association (NSW Branch) v. F C of T* (1934) 3 ATD 114 . But only purposes of profit or gain *to the individual members* preclude exemption. The ATO considers that the result in the *Australian Dental Association* case was correct because, even if the Association was carried on for profit or gain, it was not carried on for profit or gain to the individual members.

To the individual members

20. Not all profit or gain is profit or gain to individual members. In *Cappid Pty Ltd v. F C of T* 71 ATC 4121; 2 ATR 319, the High Court distinguished bodies carried on for the benefit of their members generally from those carried on for the profit or gain of their individual members:

> 'The exemption which sec. 23(g) offers is not co-extensive with all bodies which are not carried on for the benefit of their members severally or individually. Instances of corporate bodies which direct their profits or gains to the benefit of their members as a whole but not to their members individually readily come to mind.' (71 ATC at 4124; 2 ATR at 323)

A body would be carried on for the profit or gain of its individual members, even if only some of the members were to make an individual profit or gain. In *Cappid*, a company was carried on for the purpose of profit or gain to its individual members, even though those members held their interests only as trustees and even though this was known to the company.

21. Earlier cases support this view. For example, the benefits flowing from a trade association were held not to be profits to the members individually, although the members may have benefited as a group, in *re Proprietary Articles Trade Association of South Australia Inc* [1949] SASR 88. This is consistent with the result in *Australian Dental Association*, above. A superannuation fund was held not to be carried on for the gain of its individual members; the kind of mutual commercial insurance which does involve gain to the individual members is on the other side of a difficult line, but one which must be drawn (*Armour v. Liverpool Corporation* [1939] 1 Ch 422).

22. Similarly, in *Payne v. Bradley* [1961] 2 All ER 36 (CA), 882 (HL), a friendly societies' club sought to defend itself against an illegal gaming charge by relying on a statutory authorisation for lotteries where the net proceeds are applied 'for purposes other than the purposes of private gain'. The club contended that this required only no purpose of gain to individual members, and that as the club could not distribute to members the authorisation applied. The Court of Appeal held that private gain did not require any gain to an individual or individuals, and that the general gain to the members as a whole amounted to private gain; the House of Lords agreed. Lord Denning, in the course of his dissent, states the distinction between associations generally and friendly societies, as justifying the view that what might amount to profit or gain to the members individually in some other contexts does not do so when it provides a general benefit to members of a friendly society.

23. In paragraph 23(g), the legislature has distinguished between entities carried on for gain or profit to their members generally and entities carried on for gain or profit to their members individually. Personal benefits to members will not have the character of gain or profit to the members individually where the benefits are provided on the basis of criteria other than mere equity participation through contributions. This is a distinctive feature of organisations such as friendly societies, one which distinguishes them from, say, companies with shareholders. They are not carried on for the purposes of the entity itself (as, say, a museum might be). They are not carried on for a purpose distinct from the personal or individual interests of the members (as, say, a community service organisation might be). They are carried on to provide personal benefits for the advantage of those who qualify for them: that is, for members: on the happening of certain events, such as unemployment or sickness. But there is no provision for the payment of profit or gain to members on a participation basis, that is, in proportion to a member's contributions without the satisfaction of the set criteria. That prohibition is based on the requirement that the organisation not be carried on for the purpose of profit or gain to the individual members.

24. Such a requirement does not mean that there cannot be different classes of member. Some members will contribute only to particular funds for particular potential benefits. Others will contribute at a higher rate for a higher maximum potential benefit. Such variations do not mean that a body is conducted for the purposes of profit or gain to its individual members.

25. Arguably, rather than distinguishing gain or profit to the members generally from gain or profit to the members individually, another course would be to limit the meaning of gain or profit, perhaps to direct pecuniary benefits. If either view were correct, a friendly society conducting its traditional activities would not qualify for exemption because those activities generally result in a direct pecuniary benefit to those members who get benefits of any kind. Clearly, this is not what the legislature intended.

Education fund benefits

26. Education funds having characteristics described in paragraphs 8-11 provide profit or gain to individual members of the funds. They do this because they provide such profit or gain to members individually. The profit or gain is the benefit or advantage to members, the value obtained by members, in the investment of their contributions and the consequent accretion to the account which enables education benefits to be paid.

27. A friendly society offering such an education fund is carried on for the purpose of profit or gain to the individual members from the moment contributions to the fund are first taken on the basis that such accretions are sought and expected. No accretion has to occur, if it is contemplated.

28. The profit or gain need not be intended to be actually derived by the member to be profit or gain of the member, although (as *Perrot v. DC of T (NSW)* (1923) SR(NSW) 118 shows) income would need to be intended to be so derived. There is no need for a profit or gain to amount to income of the member.

29. A profit or gain to a member will arise from the payment of education expenses of a student nominated by the member. It is established that income must have the character of money or be capable of conversion into money. Profit or gain is not so restricted. The fact that an education fund, obliged to meet certain education expenses, may meet them only by payment to the student, or to the body to which the expenses have been incurred, does not mean that the member who nominates the student concerned has no profit or gain. The increase in financial resources and in the ability to have met the education expenses of a student or students chosen by the member is a

profit or gain to the member. Nor does that increase only arise if the member would otherwise be required to meet those education expenses. The increase in resources is individual to the member who benefits because the increase is personal to the member. It is based on the member's own contributions, and not on access by any of a class of members to certain benefits when their individual circumstances warrant this.

30. The recovery or withdrawal of money by a member of such a fund, whether limited to circumstances such as the failure of a student, or more liberally at the option of the member, is a profit or gain to the member individually. For instance, a member could recover the amounts he/she has deposited in the fund after accruing sufficient gain in the fund to pay the education benefits he/she wishes to pay (to the extent he/she wishes to pay them). The result would be an individual gain to the member, who retains funds yet secures an education benefit paid as the member chooses.

31. This also applies if the parent or guardian of a student incurs education expenses for the student and seeks reimbursement of those expenses from the fund. The power to have the expenses reimbursed will also represent a profit or gain to the member individually, whether or not the member is the parent or guardian reimbursed.

Paragraph 23(z) - Exemption of scholarship, bursary or other educational allowance or educational assistance

32. So far as concerns the application of paragraph 23(z) to moneys paid from an education fund having characteristics described in paragraphs 8-11, it is considered that the issue is not what is done with the money received but rather the correct nature of the receipt. The basic issues are whether the payment is income, under normal concepts, and if it is, whether it is 'income by way of a scholarship, bursary or other educational allowance or educational assistance' so as to satisfy paragraph 23(z).

Is the payment income?

33. Consideration of the question of exemption will not be necessary under paragraph 23(z) unless the payment is income under ordinary concepts. Thus, Davies and Hill JJ in *FC of T v. Ranson* 20 ATR 1652, at 1658; 89 ATC 5322, at 5327, said:

> 'Section 23(z), it must be noted, is conditional upon the relevant scholarship, bursary or allowance being income. It may be possible to conceive of an educational allowance, paid in a lump sum or even periodically as being in a particular case a mere gift

> and accordingly as not having the character of income in ordinary concepts. Generally, however, a scholarship or bursary will be income because it consists of a series of periodical receipts'.

Is the income derived by way of a scholarship, bursary or other educational allowance or educational assistance?

34. Payments of the education expenses by such an education fund do not fall within the terms of paragraph 23(z) because, if they are income, they are not derived by way of a scholarship, bursary or other educational allowance [or educational assistance - as to these words, see below]. If the payments are income, they will be assessable; if they are not income, their further tax treatment does not arise.

35. There has never been an expressed intention that the words 'scholarship, bursary or other educational allowance' be any more than a description of rewards for merit attained as a result of competition or selection on the basis of general criteria; what appeared to be in contemplation were scholarships, fellowships, prizes and bursaries and the like. There is no indication that the words 'educational allowance' were to have any different meaning than the words which preceded them nor that they be any more than a paraphrase of alternative rewards.

36. The Explanatory Memorandum to the *Income Tax and Social Services Contribution Assessment Act 1951* (Act No 44 of 1951, inserting paragraph 23(z)), said that the:

> 'purpose of [the amendment] is to give effect to a recommendation by the Commonwealth Committee on Taxation that income arising from scholarships and **similar** educational awards should be exempt from income tax... The exemption will apply...to payments under various private scholarships and **similar** educational awards...'. [emphasis added].

The Second Reading Speech used similar terminology.

37. The concept of 'educational assistance' was introduced into the paragraph in 1985. There was no intention to broaden the scope of the paragraph. In fact, the words were inserted to enable two specific forms of assistance to be excluded from the paragraph. This is confirmed by the Explanatory Memorandum to the *Taxation Laws Amendment Act (No 3) 1985* (Act No 168 of 1985).

38. The component words in 'scholarship, bursary or other educational allowance' have had some judicial consideration. For example, in *Re Leitch, deceased,* 1965 VR 204, which dealt with 'scholarship', Adam J said (at 206):

> '...I am not prepared to hold that according to common usages of speech, or by reason of any authoritative definition, the word "scholarship", in the absence of expressed purposes or conditions attached to it, connotes anything more than a grant of an emolument, normally in a sum of money, to a scholar selected on merit or upon some other rational criterion'.

39. Although *obiter*, the statement recognises the need for there to be some rationale (or criterion) for granting a scholarship: see also *Case G 56* (1985) 7 NZTC 1247, at 1250; *Reid v. Commissioner of Inland Revenue* (1985) 7 NZTC 5176, at 5190; *Case L 30* (1989) 11 NZTC 1181, at 1187. Such recognition is consistent with the explanations of the provision when it was inserted as paragraph 23(z). It would not, it is suggested, be satisfied by a payment merely because, for example, the student is nominated by a member of an education fund to receive such benefits as the member's contributions and accounts allow.

40. In the further case of *Wicks v. Firth* [1983] 2 W.L.R. 34, the House of Lords addressed a trust for the award of scholarships in which, in the words of Lord Templeman;

> 'It is the policy of the trustees to see that all eligible applicants receive by way of scholarship basic awards which make up the difference between maintenance grants made by the local educational authorities and the assessed maintenance requirements of the students, save for a sum of 300 pounds which may then be made up by merit awards or hardship awards by the trustees' (at 40).

41. The intentions were clearly that there be criteria as there had to be applicants who were eligible (i.e. satisfy criteria) for the basic awards and who could also receive awards on merit or on the satisfaction of hardship criteria. The awards were conceded by all parties to be scholarships within the meaning of section 375(1) of the *Income and Corporation Taxes Act 1970* (U.K.), a provision similar to paragraph 23(z). The facts of the case do not, however, parallel those of arrangements discussed in this Ruling.

42. In another case, *FC of T v. Hall* 5 ATR 450, at 459; 75 ATC 4156, at 4164, Rath J, in the Supreme Court of NSW, said:

> 'It is true that the exemption in s 23(z) relates to income in the hands of the scholar and not to deductibility from income of the benefactor, and that this may be thought to provide a reason for looking at the character of the receipt from the point of view of the purposes of the scholar. Though there may be logic in this approach, I think it is inconsistent with the ordinary understanding of the phrase "scholarship, bursary or other

> educational allowance". **In its ordinary meaning that collocation of words connotes a character in the income that attaches to it apart from and irrespective of the use the student makes of the money**. A scholarship is a scholarship even if the student spends it on marijuana; income of the student derived from his own rent producing properties is not exempted from his assessable income by s 23(z) even if he devotes it to his education' [emphasis added].

43. That case is therefore authority for the proposition that the proper approach is to determine the correct character of the receipt. It can, on that basis, be distinguished from *In re Compton. Powell v. Compton* [1945] 1 Ch 123, which merely concerns itself with application of certain trust funds, including scholarship funds, by trustees.

44. In *FC of T v. Ranson* 89 ATC 4353; 20 ATR 488, a case turning on the meaning in subparagraph 23(z)(i) of 'upon condition that', Gummow J adopted without dissent the dicta of Adam J in *Re Leitch* as to the meaning of 'scholarship'. On appeal to the Full Federal Court (Davies, Jenkinson and Hill JJ) (reported in 89 ATC 5322; 20 ATR 1652), *Re Leitch* was not referred to and Gummow J's interpretation of the word was not disturbed. In fact, as appears from the judgment of Davies and Hill JJ, there was agreement between the parties that the sum paid to the taxpayer was income derived by way of scholarship, bursary or other educational allowance.

45. Neither *FC of T v. Hall* nor *FC of T v. Ranson* addresses the issue of the need for criteria but nothing in either case indicates a contrary view.

Ejusdem generis rule

46. The words 'other educational allowance or educational assistance' in the phrase should be read *ejusdem generis* with the words 'scholarship' and 'bursary' on a similar basis to the decision in *Canwan Coals Pty Ltd v. FC of T* (1974) 4 ALR 223; 74 ATC 4231. There, Sheppard J held that the words 'or other facility' in ' a railway, road, pipeline or other facility' in s123A(1) of the ITAA had to be read *ejusdem generis* and that a storage facility was not covered. None of the cases referred to earlier on the application of paragraph 23(z) were (or needed to be) decided by reference to that rule. cf. *Case C 40,*
71 ATC 175.

47. Text writers (notably D C Pearce & R S Geddes, *Statutory Interpretation in Australia*, Third Edition, Butterworths, 1988 and R Wilson and B Galpin, *Maxwell on The Interpretation of Statutes*,

Eleventh Edition, Sweet & Maxwell, 1962) discuss cases in which the number of words which precede the general expression is usually three or more, for example 'a,b, c or other d'. In paragraph 23(z) only two species precede the general expressions. However, the Privy Council has said [*United Towns Electric Co v. Attorney-General for Newfoundland* [1939] 1 All E R 423, at 428] that there need [only] be more than one species mentioned to constitute a genus.

48. The context of this provision suggests that the *ejusdem generis* rule must apply to its interpretation.

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