

A co-operative approach to taxation: the application of business taxation to socially oriented co-operative entities in Australia

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Abstract

Co-operatives are business entities owned by their members and governed democratically with a view to providing benefits for their members and communities. Not driven by the need to maximise short-term profitability, they tend to have a long-term view of business, serving both economic and social needs. With a legal regime that differs from that of commercial, capital-based companies and a philosophy and purpose that are socially focused and community based, the question arises: how are co-operatives taxed in Australia? This article exposes a regime that is fragmented, ambiguous, inconsistent and complex in its application. Tax policy will become increasingly important as co-operatives, as a business model, increase.

This article was inspired by Emeritus Professor John Taylor's contribution to the literature on the taxation of business entities, including his work related to this topic.

Keywords: co-operative; mutuality; mutual income; non-profit company; not-for-profit; patronage rebates; social economy

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1. INTRODUCTION

On 14 March 1761, in Fenwick, East Ayrshire, Scotland, a group of local weavers dismayed at the downturn in weaving and wanting to help their neighbours by providing access to cheap food, dragged a sack of oatmeal into the front room of a barely furnished cottage and began selling the contents at a discount. The Fenwick Weavers' Society is considered to be the earliest known co-operative in the world for which full records exist.¹

What began as sharing equipment such as looms and raw materials within the weaving industry progressed to buying food in bulk to be sold to members and non-members at a good price, including on credit to members.² This concept of credit developed into lending small amounts of money to the families of its members making it the first recorded credit union or community-based bank. In 1808 funds were used to buy books and a library for the local community was founded. It also saw an 'emigration society' established to help members relocate abroad to take advantage of opportunities elsewhere. A victim of its own success, the Fenwick Weavers' Society collapsed in 1873 when the population of Fenwick dropped from 2,000 to 500 people, partly due to the society's emigration support program.³ Today, the co-operative movement has hundreds of millions of members worldwide.

A co-operative is an incorporated entity designed to serve the interests of its members.⁴ As a people-centred enterprise, it is 'owned, controlled and run by and for their members to realise their common economic, social, and cultural needs and aspirations'.⁵ The Co-operatives National Law of the Australian States and Territories mirrors many of the key provisions of the *Corporations Act 2001* (Cth) and directly applies other provisions. Both laws share a number of characteristics including separate legal personality, limited liability and the right to raise capital from the public in some circumstances. However, there are also differences such as, in a co-operative, a share represents membership not equity and a co-operative exists to promote member value not capital growth.⁶ Further, a co-operative is an 'excluded matter' for the purposes of the *Corporations Act 2001* (Cth)⁷ meaning that the Act does not apply other than in limited circumstances⁸ or where the State or Territory legislation includes a declaratory provision for the inclusion of a specific provision.

¹ National Library of Scotland, 'Fenwick Weavers' Society Foundation Charter, 1761' (Web Page) <<https://www.nls.uk/learning-zone/politics-and-society/labour-history/fenwick-weavers/>>.

² Johan Crawford, 'The Community Library in Scottish History' (2002) 28(5-6) *IFLA Journal* 245; John McFadzean, *The Co-operators – A History of the Fenwick Weavers* (East Ayrshire North Communities Federation Ltd, 2008).

³ The Fenwick Weavers' Society was reconvened in March 2008.

⁴ Australian Government, 'Co-operative', *Business.gov.au* (Web Page) <<https://business.gov.au/planning/business-structures-and-types/business-structures/co-operative>>. This website is described as 'a whole-of-government website for the Australian business community'. Co-operatives may also be unincorporated.

⁵ International Cooperative Alliance, 'What Is a Cooperative?' (Web Page) <<https://ica.coop/en/cooperatives/what-is-a-cooperative>>.

⁶ For a discussion on the differences between a co-operative and a company, see Ann Apps, 'Legislating for Co-operative Identity: The New Co-operatives National Law in Australia' (2016) 34(1) *Company and Securities Law Journal* 6 ('Legislating for Co-operative Identity').

⁷ See for example s 12(1) of the Appendix to the *Co-operatives (Adoption of National Law) Act 2012* (NSW) being the Co-operatives National Law (CNL) template.

⁸ *Corporations Act 2001* (Cth) s 5F(2).

Although co-operatives can do what other business entities do, they differ in structure, philosophy and purpose. These significant differences pose particular challenges, including in their taxation where some co-operatives are income tax exempt while others are not.

This article is structured as follows. Section 2 considers the prevalence of co-operatives, both domestically and internationally. A basic understanding of co-operatives is provided in section 3 where co-operatives are considered in terms of business structure, as a business entity and their regulation. This provides context for the discussion and analysis that follow. Section 4 considers the taxation of co-operatives. The section commences with a discussion of the approaches to the taxation of co-operatives and the preferential treatment they may be afforded, followed by an analysis of the taxation of co-operatives in Australia and international comparisons. Section 5 concludes.

2. THE THIRD SECTOR AND CO-OPERATIVES

Business enterprises are usually classified according to two discrete criteria: ownership (public or private) and objectives or purposes (for-profit or not-for-profit). The environment in which these enterprises operate can be separated into three sectors. The first sector consists of the public sector comprising central and local governments and their agencies while the private (or non-government), for-profit sector makes up the second sector. Here, 'for-profit' refers to a profit motive being the predominant objective. The third sector is an area that lies between the private business sector and government, between the market and the state.⁹ It comprises various organisations such as charities, associations, clubs, societies, unions, foundations, mutuals and not-for-profit co-operatives.¹⁰ It is a sector that is referred to as not-for-profit (or non-profit), the social economy or even civil society. While their objective may be to provide goods or services which may produce profits, this is achieved through collective action for a predominantly non-profit motive. That is, the difference between the second and third sectors is not so much in the type of activity, but rather in its purpose and in the way it is carried out.¹¹

This is not to say that third sector organisations do not engage in trade. Many not-for-profit co-operatives and mutuals do. While co-operatives are a type of mutual entity, the major difference between co-operatives and other types of mutual entities is that co-operatives subscribe to the seven principles of the International Co-operative Alliance.¹² However, data on these two entity forms are usually amassed making analysis of co-operatives, as a distinct business entity type, difficult. Mutual entities are found predominantly in the financial sector and include banks, mutual investment funds,

⁹ Paul Krugman, 'Cooperating for a Better Future' (2023) 107 *CIRIEC-España, Revista de Economía Pública, Social y Cooperativa* 5; Annette Zimmer and Benedikt Pahl, 'Barriers to Third Sector Development' in Bernard Enjolras et al, *The Third Sector as a Renewable Resource for Europe: Concepts, Impacts, Challenges and Opportunities* (Palgrave Macmillan, 2018) 125.

¹⁰ Mark Lyons and Andrew Passey, 'Need Public Policy Ignore the Third Sector? Government Policy in Australia and the United Kingdom' (2006) 65(3) *Australian Journal of Public Administration* 90.

¹¹ Juan José Hinojosa Torralvo, 'European Taxation of Cooperatives: An Examination of the Possibilities Offered by the New Concept of Limited Profitability' (2022) 4 *International Journal of Cooperative Law* 64, 74.

¹² Australian Parliament, Senate Economics References Committee, *Cooperative, Mutual and Member-Owned Firms* (Report, March 2016) [2.6]; UK Parliament, House of Commons, Communities and Local Government Committee, *Mutual and Co-operative Approaches to Delivering Local Services* (Fifth Report of Session 2012–13, HC 112, 21 November 2012) [2.10].

superannuation funds, credit unions and insurance companies. They also dominate health insurers (eg, HCF, Australian Unity) and motoring organisations (eg, RACV, NRMA). They also tend to dominate the data and statistics.¹³

2.1 Co-operatives in Australia

In Australia, co-operatives operate in a diverse range of sectors including agriculture, arts, child care, communications, community services, education, energy, finance, hardware, health care, housing, radio broadcasting, fishing, manufacturing, retail, superannuation funds, transport and wine sales.¹⁴ It has been claimed that eight in every 10 Australians are members of a co-operative or mutually owned enterprise.¹⁵ This survey, conducted by the Australia Institute, included automobile clubs that are often, but not always, co-operatives or mutuals.

The largest co-operatives by gross annual turnover are in the wholesale and retail trade industries, predominantly in agribusiness. For example, Co-operative Bulk Handling Ltd (CBH Group), a grain growers' co-operative that handles, markets and processes grain from the wheatbelt of Western Australia and includes the operation of four port terminals, had revenue of AUD 6.22 billion in the 2021-22 financial year.¹⁶ Figure 1 depicts the top 20 Australian co-operatives in terms of gross annual turnover for the 2021-22 year. The majority (11) are in the wholesale industry, followed by retail (5), manufacturing (3) and childcare (1). That only 14 co-operatives had gross annual turnover exceeding AUD 100 million indicates that co-operatives may be a preferred structure for smaller entities.

¹³ See generally Business Council of Co-operatives and Mutuals, *2023 National Mutual Economy Report, Incorporating the Top 100 Co-operatives and Mutuals (2023)* ('2023 National Mutual Economy Report'); Co-operative Development Services Ltd, 'Top 20 Australian Co-operatives', *Australian Co-operative Links* (Web Page, September 2023) <<https://www.coopdevelopment.org.au/topcoopsau.html>>.

¹⁴ For a history of co-operatives in Australia see Nikola Balnave and Greg Patmore, 'The History of Co-operatives in Australia' in Australian Bureau of Statistics (ABS), *Year Book Australia, 2012* (Catalogue No 1301.0, 24 May 2012).

¹⁵ Richard Denniss and David Baker, *Who Knew Australians Were So Co-operative? The Size and Scope of Mutually Owned Co-ops in Australia* (The Australia Institute, October 2012) <<https://australiainstitute.org.au/report/who-knew-australians-were-so-co-operative-the-size-and-scope-of-mutually-owned-co-ops-in-australia/>>.

¹⁶ Business Council of Co-operatives and Mutuals, *2023 National Mutual Economy Report*, above n 13, 23. CBH Ltd was retrospectively endorsed as a charitable institution with effect from 1 July 2000: CBH Group, *90 Harvests Strong: Annual Report 2023*, Notes to the consolidated financial statements, 88. Australian Charities and Not-for-profits Commission (ACNC), 'Co-operative Bulk Handling Limited' (Charity Register) <<https://www.acnc.gov.au/charity/charities/b9ef6be7-39af-e811-a95e-000d3ad24c60/profile>>.

Fig. 1: Top 20 Australian Co-operatives by Gross Annual Turnover (2021-22)

	\$1billion+	\$1bn - \$500m	\$500m - \$100m	\$100m - \$50m	\$50m - \$30m	
	Name of Co-operative				Industry	State
1	Co-operative Bulk Handling Ltd				Wholesale	WA
2	Norco Co-operative Ltd				Manufacturing	NSW
3	Western Australian Meat Marketing Co-operative Ltd				Wholesale	WA
4	Independent Liquor Group Distribution Co-operative Ltd				Wholesale	NSW
5	Independent Liquor Group (Suppliers) Co-operative Ltd				Wholesale	NSW
6	Geraldton Fishermen's Co-operative Ltd				Wholesale	WA
7	Oz Group Co-op Ltd				Wholesale	NSW
8	Northern Co-operative Meat Company Ltd				Manufacturing	NSW
9	Yenda Producers Co-operative Society Ltd				Retail	NSW
10	Plumbers Supplies Co-operative Ltd				Wholesale	NSW
11	New South Wales Sugar Milling Co-operative Ltd				Manufacturing	NSW
12	Hastings Co-operative Ltd				Retail	NSW
13	Victorian Aboriginal Child Care Agency Co-operative Ltd				Child Care	Vic
14	CCW Co-operative Ltd				Wholesale	SA
15	Tasmanian Independent Retailers Co-operative Society Ltd				Wholesale	Tas
16	Dairy Farmers Milk Co-operative Ltd				Wholesale	NSW
17	Master Butchers Co-operative Ltd				Wholesale	SA
18	The Community Co-operative Store (Nuriootpa) Ltd				Retail	SA
19	N.Q. Co-op Ltd				Retail	Qld
20	Mount Barker Co-operative Ltd				Retail	WA

Source: Co-operative Development Services Ltd (2023), 'Top 20 Australian Co-operatives', *Australian Co-operative Links* (Web Page, September 2023) <<https://www.coopdevelopment.org.au/topcoopsau.html>>.

Statistics on co-operatives in Australia are lacking. A feature article on co-operatives in the Australian economy and society was included in the Australian Bureau of Statistics (ABS) 2012 *Year Book*, with 2012 being the United Nations International Year of Co-operatives¹⁷ but there has not been much research or discussion since then. There has, until very recently when the Commonwealth government added co-operatives to the types of business structures on the business.gov.au website, been a lack of recognition of 'co-operatives' as a type of entity, for example, by the ABS. Co-operatives were classified as other types of entities, including 'Australian public company', 'Other

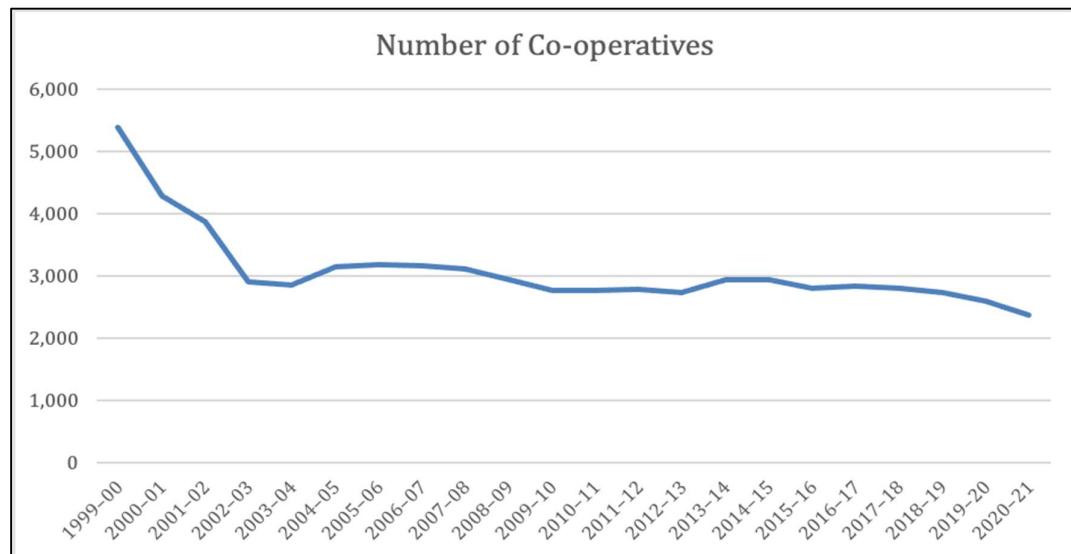
¹⁷ ABS, *Year Book Australia, 2012*, above n 14. Note this was the last year the ABS produced Year Books.

incorporated entity' and 'Other unincorporated entity' on the Australian Business Register.¹⁸ The ABS Business Register is based on these entity types with the consequence that co-operatives cannot be reliably captured in ABS business surveys.

Tax data on co-operatives is also lacking. Since the 2012-13 income year, co-operatives have been relegated to the 'other' category in the tax statistics, along with non-profit, strata title and similar entities. But, as 'co-operative' is a recognised business form on the company tax return, the Australian Taxation Office's (ATO) statistics do capture the number of co-operatives on an annual basis. In addition, there are discrepancies between the ATO's statistics and the (few) statistics provided by the ABS. The ABS reports 2,350 registered co-operatives in 2000 and 1,700 in 2012.¹⁹ The ATO reported 5,380 in 1999-2000 and 2,775 in 2011-12.²⁰

Nevertheless, from the data available, it would appear that the number of co-operatives in Australia has been declining. Figure 2 shows the number of entities that have classified themselves as 'co-operative' in their income tax returns.²¹

Fig. 2: Number of Co-operatives in Australia (Income Tax Returns 1999-2000 to 2020-21)



Source: Adapted from ATO, *Taxation Statistics 2020-21* (2023) Companies: Selected Items, for income years 1980-81 to 2020-21, Table 1A.

¹⁸ Ibid. See also Business Council of Co-operatives and Mutuals, BCCM Federal Budget Submission 2019/20 (February 2019). Each co-operative has to update their ABN in order to change the entity status on the register.

¹⁹ ABS, above n 14.

²⁰ Australian Taxation Office (ATO), *Taxation Statistics 2020-21* (2023) Company Detailed Tables, Table 1 <<https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/taxation-statistics/taxation-statistics-previous-editions/taxation-statistics-2020-21/statistics/company-statistics?anchor=Companies#ato-Companydetailedtables>>.

²¹ Ibid.

This decrease in numbers could be due to restrictions and additional compliance costs in the regulatory environment (discussed in section 3.3) and/or a lack of understanding, training and support for the sector.²² Alternatively, or in addition, increased demutualisation may be a contributing factor. This could result from members cashing in on strong balance sheet growth or a change in business structure, or be the result of an ageing and diminishing membership.²³ Yet equally it is open for member-owned organisations that embrace co-operative principles to opt to register under the *Corporations Act 2001* (Cth) instead of the relevant State or Territory co-operative laws. While State and Territory co-operative laws are now ‘uniform’, the lack of national legislation may be a contributing factor to the decline in numbers.

The Business Council of Co-operatives and Mutuals reports that, during the 2019-20 financial year, Australia’s co-operatives and other mutuals (excluding superannuation funds) had a combined turnover of more than AUD 35.3 billion with an active membership exceeding 31.1 million, increasing to AUD 40.4 billion and 33.3 million respectively in 2021-22.²⁴ These numbers are not insignificant.

2.2 Co-operatives internationally

Due to the lack of cohesive reporting, international statistics should be considered as suggestive only. Nevertheless, they are indicative of a substantial form of business enterprise.

There are estimated to be 3 million co-operatives and other mutuals globally, with a membership exceeding 1 billion,²⁵ or ‘more than 12% of humanity’.²⁶ In New Zealand, Canada and France, around 40 per cent of their population are members of a co-operative with Finland and Singapore even higher.²⁷ Co-operatives therefore contribute significantly to national economies, through economic activity and employment. The global spread of numbers of co-operatives and members as at 2018 is depicted in Figure 3.

²² Richard O’Leary and Sam Byrne, *Co-operatives in Australia: A Manual* (Co-operative Federation of NSW, 2nd ed, 2017).

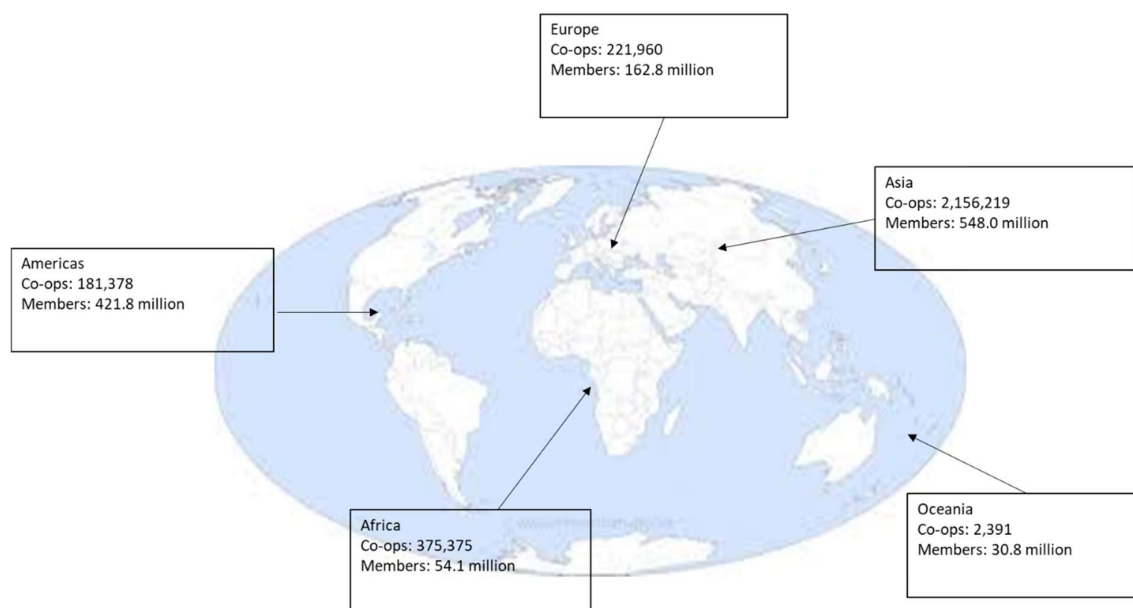
²³ ABS, above n 14.

²⁴ Business Council of Co-operatives and Mutuals, *2023 National Mutual Economy Report*, above n 13, 14-16.

²⁵ *Ibid* 19.

²⁶ International Cooperative Alliance, ‘Facts and Figures’ (Web Page) <<https://www.ica.coop/en/cooperatives/facts-and-figures>>.

²⁷ ABS, above n 14.

Fig. 3: Number of Co-operatives and Membership Globally (2018)

Source: Adapted from Cooperative Business New Zealand, *The New Zealand Co-operative Economy* (2021).

Globally, in 2022, the largest 300 co-operatives and mutuals collectively reported total turnover of USD 2,170.99 billion.²⁸ Even a decade ago, agribusiness featured prominently with Canadian maple sugar co-operatives producing 35 per cent of the world's production, French co-operatives producing 40 per cent of food and agricultural production and 91 per cent of all Japanese farmers being co-operative members.²⁹ In New Zealand, 3 per cent of gross domestic product was generated by co-operatives which held 95 per cent of the dairy market, 70 per cent of the meat market, 60 per cent of the farm supply market and 80 per cent of the fertiliser market.³⁰

3. CO-OPERATIVES

3.1 Co-operatives as a business structure

A co-operative is an entity designed to serve the interests of its members. These interests may be economic, social or cultural. It is a structure that encourages member contribution and shared responsibility. With people (ie, members) at the centre of the organisation, any trade for surplus is designed to further or fulfil their purpose rather than being focused on maximising a financial return on investment.

²⁸ International Cooperative Alliance and Euricse, *World Cooperative Monitor: Exploring the Cooperative Economy* (December 2022) 13, 20.

²⁹ ABS, above n 14.

³⁰ Ibid.

There are two types of co-operatives: distributing and non-distributing.³¹ A distributing co-operative has shares and can distribute any surplus funds to members. This can be done by way of the issue of a dividend or of bonus shares, or by way of a rebate. While any distribution may be based on each member's shareholding, profits can be distributed to members based on their level of use of the co-operative's services. A non-distributing co-operative cannot, by definition, distribute surplus funds to members and therefore does not require share capital. It is not, however, prohibited from issuing shares, the consequence of which is that a regular subscription fee is then not required.³² Any profits are reinvested back into the co-operative such as into improved products and services. A non-distributing co-operative is likely to meet the definition of being 'not-for-profit' for tax purposes, although being not-for-profit does not necessarily mean the entity is exempt from tax.

Previously, distributing and non-distributing co-operatives were known as trading and non-trading co-operatives, respectively. But this does not prevent a non-distributing co-operative from engaging in trading activities. It does mean that any surplus (profit) is to be used to further the entity's purpose.

Co-operatives are democratic organisations that focus on concepts of self-help, equality and responsibility. Their values are enshrined in what is referred to as the 'Rochdale Principles'.³³ Co-operatives around the world generally operate according to these same seven core principles adopted by the International Co-operative Alliance in 1995 and now incorporated into Australian law.³⁴ In summary these are:

1. Voluntary and open membership – ie, non-discriminatory.
2. Democratic member control – ie, active participation by members.
3. Member economic participation – ie, equitable contributions with membership benefits.
4. Autonomy and independence – ie, self-help on terms that ensure democratic control.
5. Education, training and information – ie, ensure effective contributions and public awareness.
6. Co-operation among co-operatives – ie, strength through local, national and international structures.
7. Concern for community – ie, sustainable development of communities.

³¹ See, for example, *Co-operatives (Adoption of National Law) Act 2012* (NSW), above n 7, s 17.

³² Australian Government, above n 4.

³³ The Rochdale Equitable Pioneers Society, formed in 1844, is credited with laying the foundation of the modern co-operative model. International Cooperative Alliance, 'The Rochdale Pioneers' (Web Page) <<https://ica.coop/en/rochdale-pioneers>>.

³⁴ National Cooperative Business Association CLUSA International, 'Our Cooperative Identity' (Web Page) <<https://nbaclusa.coop/resources/7-cooperative-principles/>>; International Co-operative Alliance, *Guidance Notes to the Co-operative Principles* (2015). See, for example, *Co-operatives (Adoption of National Law) Act 2012* (NSW), above n 7, s 10; *Co-operatives National Law Application Act 2013* (Vic) s 10.

Being a distinct legal entity as a consequence of being registered as a co-operative, members of both distributing and non-distributing co-operatives have equal voting rights³⁵ and liability is limited.³⁶ A key element of membership is that all members, of which there must be a minimum of five, must maintain an active relationship with their co-operative.³⁷ This is usually achieved by using or contributing to its main activities which could be being a customer of, a supplier to, or a worker in, a co-operative. In turn, a worker could be an employee paid to perform a particular role, a contractor paid to provide a particular service or a volunteer who may be ‘paid’ in the form of discounts, credits or vouchers.

3.2 Co-operatives as a business entity

It has been argued that many Australians ‘have lost confidence in the ability of profit maximising firms to make decisions in society’s interests’,³⁸ as well as their failure to make decisions that meet community expectations.³⁹ Indeed, the majority of Australians believe that corporate Australia is too focused on profit and not concerned enough with their customers.⁴⁰ Recent scandals such as Westpac’s money laundering, Rio Tinto’s destruction of sacred sites in Juukan Gorge, Qantas not honouring flight credits and the Optus outage has arguably fuelled the growing tide of resentment.⁴¹

As required by the co-operative principles, co-operatives are more likely to put people ahead of profits, for example by being concerned about community. As values- and principles-based enterprises, they are more likely to exist for the greater good of the many and not for the financial gain of a few. Not driven by the need to maximise short-term profitability, they tend to have a long-term view of business, serving both economic and social needs. They may also operate in remote and rural areas that are typically unattractive investments for for-profit enterprises. In addition, the ‘one member one vote’ principle contrasts with many listed companies where the power and/or influence is vested in a few shareholders.

Co-operatives play a significant role in employment creation, although many are reliant on volunteers.⁴² They provide a means of transitioning from the informal economy to

³⁵ *Co-operatives (Adoption of National Law) Act 2012* (NSW), above n 7, Annexure, Part 1.3; *Co-operatives National Law Application Act 2013* (Vic), above n 34, Annexure, Part 1.3.

³⁶ *Co-operatives (Adoption of National Law) Act 2012* (NSW), above n 7, s 121; *Co-operatives National Law Application Act 2013* (Vic), above n 34, s 121.

³⁷ *Co-operatives (Adoption of National Law) Act 2012* (NSW), above n 7, s 119.

³⁸ Denniss and Baker, above n 15, 4; Tim Mazzarol, ‘Co-operatives and Social Enterprise: Are They a Replacement for Mainstream Capitalism?’, *The Conversation* (4 November 2012).

³⁹ Louise Davidson, ‘ACSA Statement on Westpac CEO and Board Changes’ (Media Release, 26 November 2019).

⁴⁰ Denniss and Baker, above n 15. See also International Labour Office, ‘Rediscovering Cooperatives: Young People Finding Work the Cooperative Way’ (Cooperatives and the World of Work No 4, 2015).

⁴¹ Ian Verrender, ‘Alan Joyce and Kelly Bayer Rosmarin Have Joined a Long Line of CEOs Who Failed to Win the Blame Game’, *ABC News* (28 November 2023).

⁴² Eum Hyung-sik, *Cooperatives and Employment: Second Global Report, Contribution of Cooperatives to Decent Work in the Changing World of Work* (CICOPA, 2017); Bruno Roelants, Eum Hyungsik and Elisa Terrasi, *Cooperatives and Employment: A Global Report* (CICOPA, 2014); OECD, *Platform Cooperatives and Employment: An Alternative for Platform Work* (OECD Local Economic and Employment Development Papers 2023/16, 2023). For reliance on volunteers see Lyons and Passey, above n 10, 90 where, referring to third sector organisations in Australia, they state ‘there are several hundred thousand that are entirely reliant on volunteers’.

the formal economy. Often this is through skill development. It has been suggested that placing people at the centre of development is more likely to ensure equality.⁴³

Environmental sustainability is a particular strength of co-operatives. The co-operative movement is very much engaged in the *2030 Agenda for Sustainable Development* with its 17 Sustainable Development Goals.⁴⁴ Many co-operatives, especially those operating in the development space, are committed to using natural resources in a sustainable way, and promoting sustainable practices to the community. They are also ‘early adopters of sustainability reporting, with many co-operatives tracking and making available data on their environmental impacts’.⁴⁵ In July 2023, CBH Group became the first grain marketer in Australia to achieve carbon neutral certification for a product.⁴⁶

Increasingly recognised as enterprises that promote sustainable development across the three dimensions of social development, economic development and environmental protection,⁴⁷ co-operatives are being seen as a more attractive business model than traditional enterprises. Food co-operatives, for example, now constitute a vital part of the alternative food movement along with farmers markets.⁴⁸ Food co-operatives generally have stringent standards about what they will or will not sell, favouring local and organic products. Ethical consumption is becoming more accepted as mainstream,⁴⁹ denoted by terms such as ‘green’, ‘fair trade’, ‘responsibly sourced’ and ‘eco-consumerism’.

Co-operatives may play an important role in sustaining a strong, tolerant and cohesive society.⁵⁰ With their core principles and community focus, co-operatives are sources of social capital that can foster a sense of community, empowerment and inclusion. In relation to the third sector generally, it has been said that it is the capacity for self-organisation, that is, the readiness of people ‘voluntarily to work together without direction from government and without the lure of profit or the necessity of earning a wage ... [that] is sometimes referred to as social capital’.⁵¹ Not only is this at the heart of a sustainable society but it is a necessary underpinning for the effective operation of a market economy.⁵²

⁴³ International Cooperative Alliance, *Co-ops for 2030: A Movement Achieving Sustainable Development for All, Annual Report Vol 1* (2017) (‘*Co-ops for 2030*’).

⁴⁴ International Cooperative Alliance, ‘Cooperatives: Key Partners in Realizing the Agenda 2030 for Sustainable Development’ (Position Paper, 2023).

⁴⁵ International Cooperative Alliance, *Co-ops for 2030*, above n 43, 24.

⁴⁶ CBH Group, ‘CBH Achieves Climate Active Carbon Neutral Certification’ (Media Release, 21 July 2023).

⁴⁷ United Nations, General Assembly, *Cooperatives in Social Development: Report of the Secretary-General, A/78/187*, report pursuant to General Assembly resolution 76/135, 17 July 2023.

⁴⁸ Andrew Zitcer, ‘Food Co-ops and the Paradox of Exclusivity’ (2015) 47(3) *Antipode* 812.

⁴⁹ Rebecca Walker Recsek and Julie R Irwin, ‘Ethical Consumption’ in Michael I Norton, Derek D Rucker and Cait Lambertson (eds), *The Cambridge Handbook of Consumer Psychology* (Cambridge University Press, 2015) 507; Colin Foad, Geoff Haddock and Gregory Maio, ‘Hypocrisy in Ethical Consumption’ (2022) 13 *Frontiers in Psychology* 880009; Alex Hiller and Helen Goworek, *Ethical Consumption: A Research Overview* (Routledge, 2023).

⁵⁰ Lyons and Passey, above n 10, 90.

⁵¹ Mark Lyons, ‘The Legal and Regulatory Environment of the Third Sector’ (2003) 25(1) *Asian Journal of Public Administration* 87, 88.

⁵² Robert D Putnam, *Bowling Alone: The Collapse and Revival of American Community* (Simon and Schuster, 2000).

Since the 2008 Global Financial Crisis and perhaps fuelled by corporate excesses, the concept of the co-operative as a business entity has been gaining traction.⁵³ In 2021 the Commonwealth government added co-operatives to the types of business structures on the business.gov.au website.⁵⁴ However, as a consequence of their differences in terms of structure, philosophy and purpose, co-operatives are not considered the same as other business entities. And they are not necessarily substitutes for, or alternatives to, mainstream for-profit companies. Indeed, many could be considered too socially oriented to be 'for-profit' enterprises. However, there clearly is a place for co-operatives as a type of business entity.

3.3 The regulation of co-operatives

From a regulatory perspective, Australian co-operatives, as a business model, have a short history.⁵⁵

The Australian *Constitution* expressly sets out the federal government's specific law-making powers.⁵⁶ Excluded from this, and therefore remaining with the States, is the power to make laws with respect to the formation of corporations (including co-operatives) and the power to regulate financial mutuals, as opposed to banks. It is only through the referral of powers from the States that a national scheme in relation to corporations can exist.⁵⁷ This transpired with the *Corporations Act 2001* (Cth) which, nevertheless, contemplates the possibility that a State or Territory may declare a particular matter to be an 'excluded matter' in relation to the whole or some specified portion of the Act.⁵⁸

While the corporations model prospered in the federal jurisdiction, the legislation and regulations pertaining to co-operatives has remained State- and Territory-based. Co-operatives that chose to register as companies,⁵⁹ or are financial co-operatives⁶⁰ and are required to register as companies, are governed and regulated as corporations notwithstanding that they are distinguished from other corporations by their commitment to co-operative principles.⁶¹ Non-distributing co-operatives that are not registered as companies and non-financial co-operatives remained under State or Territory jurisdiction.

⁵³ Claudia Sanchez Bajo and Bruno Roelants, 'Mainstreaming Co-operatives After the Global Financial Crisis' in Anthony Webster, Linda Shaw and Rachael Vorberg-Rugh (eds), *Mainstreaming Co-operation: An Alternative for the Twenty-First Century?* (Manchester University Press, 2016) 14; Sonja Novkovic, 'Cooperative Identity as a Yardstick for Transformative Change' (2022) 93(2) *Annals of Public and Cooperative Economics* 313.

⁵⁴ Luke Michael, 'Co-ops and Mutuals Move into the Mainstream', *Pro Bono Australia* (1 June 2021) <<https://probonoaustralia.com.au/news/2021/06/co-ops-and-mutuals-move-into-the-mainstream/>> (accessed 21 August 2024).

⁵⁵ In New South Wales, for example, the *Co-operatives Act 1992* (NSW) shifted the focus of co-operatives from a development tool to a 'corporate business model': Ann Apps, 'A Brief History of Co-operative Law in NSW – Acknowledging the Contribution of Dr Gary Lewis' (presentation, 2019) <https://business.sydney.edu.au/data/assets/pdf_file/0007/440098/History-of-Co-op-Law_Ann-Apps.pdf>.

⁵⁶ *Commonwealth of Australia Constitution Act 1900* s 51.

⁵⁷ Kenneth Wiltshire, 'Australian Federalism: The Business Perspective' (2008) 31(2) *University of New South Wales Law Journal* 583.

⁵⁸ *Corporations Act 2001* (Cth) s 5F.

⁵⁹ Includes distributing co-operatives that have a share capital.

⁶⁰ Includes co-operatives that are mutual banks, building societies and credit unions.

⁶¹ Apps, 'Legislating for Co-operative Identity', above n 6.

Nevertheless, shortly after referring its power with respect to corporations, New South Wales commissioned a review of the *Co-operation Act 1923* (NSW), an aspect of which was the potential harmonisation of co-operative law with the law applicable to corporations generally.⁶² John Taylor noted that the report ‘raises fundamental issues relevant to all co-operatives which conduct business in increasingly deregulated market economies’, concluding that ‘legal, financial and general commercial developments have meant that traditional co-operative structures have to an extent been found wanting’.⁶³

The first attempt to harmonise co-operative legislation between the States and Territories was made in the mid-1990s through an intergovernmental agreement, the Co-operatives Law Agreement.⁶⁴ Uniform legislation that would be consistent across all jurisdictions was to be based on core consistent provisions. However, the agreement was not signed by Western Australia and some States sought to retain certain provisions not agreeable to the other jurisdictions.⁶⁵ By 2007 it was recognised that this regulatory regime imposed restrictions and compliance costs on co-operatives and placed them at a competitive disadvantage when compared to other entities.⁶⁶

In 2011, the States and Territories entered into the Australian Uniform Co-operatives Laws Agreement to implement a scheme to promote uniform or consistent legislation and systems of administration for co-operatives.⁶⁷ The national framework included a model template, the Co-operatives National Law (CNL). This process began in 2012 with New South Wales and Queensland was the last to adopt the law in 2020.⁶⁸ This governance structure is what differentiates co-operatives from other member-based entities. Co-operatives are required to register under the CNL while clubs and societies may be unincorporated or incorporated associations, the latter falling under each State or Territory’s associations incorporation legislation.⁶⁹

The CNL enables co-operatives to operate on a national level whilst reducing red tape and the cost of compliance between jurisdictions, with simplified financial reporting for

⁶² Blake Dawson Waldron and Dominguez Barry Samuel Montagu Ltd, ‘Interim Report to the Minister for Business and Consumer Affairs on Review of the Co-operation Act 1923’ (Sydney, 1990).

⁶³ C John Taylor, ‘Reform of Co-operative Legislation in New South Wales, Australia’ (1991) *Yearbook of Co-operative Enterprise* 107, 118 (‘Reform of Co-operative Legislation’).

⁶⁴ Apps, ‘Legislating for Co-operative Identity’, above n 6; Co-operative Development Services Ltd, ‘Australian National Co-operatives’, *Australian Co-operative Links* (Web Page, March 2021) <<https://www.coopdevelopment.org.au/natlinks.html>>.

⁶⁵ Co-operative Development Services Ltd, above n 64.

⁶⁶ Ministerial Council for Consumer Affairs, ‘Co-operatives: A National Approach’ (Co-operatives National Law, Decision Making Regulatory Impact Statement, 2012)

⁶⁷ The Australian Uniform Co-operatives Laws Agreement (AUCLA) was an agreement between the Ministers responsible for consumer protection and co-operatives in each State and Territory and commenced in February 2012.

⁶⁸ *Co-operatives National Law Act 2020* (Qld); *Co-operatives National Law (ACT) Act 2017* (ACT); *Co-operatives Act 2009* (WA) amended by the *Co-operatives Amendment Act 2016* (WA); *Co-operatives National Law (Tasmania) Act 2015* (Tas); *Co-operatives (National Uniform Legislation) Act 2015* (NT); *Co-operatives National Law Application Act 2013* (Vic), above n 34; *Co-operatives National Law (South Australia) Act 2013* (SA); *Co-operatives (Adoption of National Law) Act 2012* (NSW), above n 7.

⁶⁹ Other differences include membership (co-operatives usually restricted to those who contribute or use the services while clubs and societies are open to various groups), decision-making (co-operatives have a democratic decision-making process involving all members while decisions in clubs and societies are made by a few individuals) and ownership of property (co-operatives are collective while clubs and societies can be individual as well as collective). See for example *Associations Incorporation Act 2009* (NSW); *Associations Incorporation Reform Act 2012* (Vic).

co-operatives categorised as ‘small’. While there are also differences between co-operatives in terms of type of trade (such as agriculture, childcare and arts and crafts) and types of members (such as consumer, producer and worker), the CNL only differentiates between ‘distributing’ and ‘non-distributing’ (previously trading and non-trading) co-operatives.⁷⁰ The CNL is accompanied by national regulations and local regulations. The national regulations are consistent across all States and Territories and supplement the CNL. The local regulations, on the other hand, address matters specific to that State or Territory, such as fees and penalties which means there could be differences between the various jurisdictions.

In March 2016 the Senate Economics References Committee delivered a report on the role, importance and overall performance of co-operative, mutual and member-owned entities.⁷¹ As the then CEO of the Business Council of Co-operatives and Mutuals noted: ‘It is an important first step in recognising how co-operative and mutual enterprises ... increase competition and diversity in markets and contribute to a stable and resilient economy’.⁷²

In 2017 the Parliamentary Friends of Co-ops and Mutuals Group was formed in Federal Parliament. Also in 2017 the ASX Governance Principles were adapted to apply to co-operatives and mutuals.⁷³ In 2019 legal changes were made to the *Corporations Act* to recognise Mutual Companies and Mutual Capital Instruments.⁷⁴ However, it was not until 2021 that the business.gov.au website was updated to include co-operatives as a business model.

In regulation too, co-operatives are very different to all other forms of business entities. Co-operatives have a legal regime that differs from that of commercial, capital-based companies. The identity of co-operatives is intrinsically intertwined with the co-operative principles. These differences pose particular challenges, not least with regard to taxation, and the question arises: should co-operatives be taxed differently?

4. THE TAXATION OF CO-OPERATIVES

4.1 Approaches to the taxation of co-operatives

There are two approaches to the taxation of co-operatives: entity taxation and flow-through taxation. In addition, preferential treatment may be afforded through the principle of mutuality and tax incentives. Few countries have developed a specific and consistent taxation framework for taxing co-operatives. Some provide specific provisions, some reduced tax rates, but not necessarily consistently across all co-operatives. Different criteria apply, according to the policy priorities of the legislator at any given time.

⁷⁰ See for example ss 17-19 of the Appendix to the *Co-operatives (Adoption of National Law) Act 2012* (NSW), above n 7, being the CNL template.

⁷¹ Australian Parliament, Senate Economics References Committee, above n 12.

⁷² Melina Morrison, quoted in Business Council of Co-operatives and Mutuals, ‘Senate Recommends Level Playing Field for Co-ops and Mutuals’ (16 March 2016) <<https://bccm.coop/deadline-for-submissions-to-senate-inquiry-set-for-1-july/>>.

⁷³ Business Council of Co-operatives and Mutuals, *2023 National Mutual Economy Report*, above n 13, 8.

⁷⁴ These related to Recommendations 4 and 17 of the Senate report: Australian Government, *Australian Government Response to the Senate Economics References Committee Report: Cooperative, Mutual and Member-Owned Firms* (November 2017).

4.1.1 Entity taxation

Under entity taxation, the vehicle (for example, a co-operative) is treated as an entity and tax is applied at the entity level based on the entity's attributes, but tax is also applied at the owner level (in the case of a co-operative, this is the member level). This double taxation is mitigated through the imputation system whereby the extent to which the entity has paid tax on its income is taken into account in calculating the tax that is payable at the member or shareholder level.⁷⁵

With respect to trading with members, the tax legislation provides the co-operative with a deduction for amounts distributed to members while taxing undistributed income that has been derived from trading.⁷⁶

4.1.2 Flow-through taxation

With flow-through taxation, any income is passed straight through to the owners or investors, be they members or shareholders, with the consequence that these individuals, and not the entity itself, are taxed on profits. This type of taxation applies to partnerships and trusts.

Members either invest capital or subscribe on an annual basis to co-operatives thereby providing co-operatives with capital to perform their functions. Yet members are also receivers of goods or services, for example as purchasers. The 'dividend' (or benefit) they receive is not paid on the capital but rather on the purchases or other contribution made.

The return of the surplus is sometimes referred to as patronage rebates, refunds, discounts or net margins. The distribution of benefits is in proportion to individual dealings rather than in proportion to capital investment. To illustrate: if a co-operative has a surplus of \$5,000 for the year and Member Jane accounted for 5 per cent of the business conducted, then Member Jane receives a refund or patronage rebate of \$250, being 5 per cent of the \$5,000.

In Australia, there is an underlying policy against flow-through taxation when the business form, for example a corporation, reduces members' risk via liability protection.⁷⁷ Thus, flow-through taxation does not apply to co-operatives. In the United States, the general principle of co-operative income tax is that the co-operative is a flow-through entity, providing single-level tax treatment.⁷⁸ Any surplus flows through the co-operative to its patrons where it is ultimately taxed. This only applies to co-operative income sourced from members (that is, mutual receipts) that are distributed to members.⁷⁹

⁷⁵ Under Australian income tax law this follows from *Income Tax Assessment Act 1997* (Cth) s 4-1 (ITAA 1997), ie, the entity as well as the individual are taxpayers.

⁷⁶ Under Australian income tax law this follows from *Income Tax Assessment Act 1936* (Cth) s 120 (ITAA 1936).

⁷⁷ Brett Freudenberg, 'Australia's Struggle With Tax Transparent Companies' (2007) 48(1) *Tax Notes International* 83.

⁷⁸ Unless the co-operative adopts the form of a C corporation then the co-operative itself is the taxpayer.

⁷⁹ Donald A Frederick, *Income Tax Treatment of Cooperatives: Background* (United States Department of Agriculture Cooperative Information Report 44-1, 2013) 26.

4.1.3 Mutuality principle

Some entities in Australia obtain the benefit of the principle of mutuality in relation to dealings with members. The effect is that mutual receipts are not taxable income. In *Royal Automobile Club of Victoria v Federal Commissioner of Taxation*⁸⁰ (*RACV*), Anderson J stated:

It has been long established and many times reaffirmed that in the field of income tax the principle of mutuality may relieve wholly or in part certain associations from liability to tax.⁸¹

In *Social Credit, Savings and Loans Society Ltd v Commissioner of Taxation*, Gibbs J succinctly described the principle as:

[W]here a number of people, associated together for a common purpose, have contributed to a common fund in which all the contributors are interested, the surplus of their contributions remaining after the fund has been applied to the common purpose 'is in essence a return of their own moneys which they have overpaid and is not a profit'.⁸²

The mutuality principle is dependent upon the existence of an 'identity' between contributors to the entity and those who are entitled to participate in it. The identity required is not an identity between individuals, but an identity between classes, and all that is required is a reasonable relationship between what a member contributes, and the member's expected participation.⁸³ To the extent that the entity deals with or extends its facilities to non-members, then to that extent the element of mutuality is missing.⁸⁴

The concept of mutuality is that the contributing members must be entitled to the recoupment or refund of any surplus with the result that the entity does not make a profit from them.⁸⁵ But it applies equally to contributions made. For example, annual subscriptions have been held to be, in substance, advances of capital for a common purpose and so not 'income' of the entity.⁸⁶ Any excess of income over costs is usually termed a surplus, rather than a profit.

The principle of mutuality, determined by case law,⁸⁷ recognises that 'any surplus arising from contributions to a common fund created and controlled by people for a

⁸⁰ *Royal Automobile Club of Victoria v Federal Commissioner of Taxation* (1974) 4 ATR 567 ('*RACV*').

⁸¹ *Ibid* 569, referring to *Social Credit, Savings and Loans Society Ltd v Federal Commissioner of Taxation (Com.)* (1971) 125 CLR 560 ('*Social Credit, Savings and Loans Society*'); *Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation* (1946) 73 CLR 604 ('*Colonial Mutual Life Assurance Society*'); *Sydney Water Board Employees' Credit Union Ltd v Federal Commissioner of Taxation* (1973) 129 CLR 446 ('*Sydney Water Board*').

⁸² *Social Credit, Savings and Loans Society*, above n 81, 570-571, citing *Colonial Mutual Life Assurance Society*, above n 81, 618-619.

⁸³ *Sydney Water Board*, above n 81, 457; *Social Credit, Savings and Loans Society*, above n 81, 571-572.

⁸⁴ *RACV*, above n 80.

⁸⁵ *Jones v South-West Lancashire Coal Owners Association Ltd* [1927] AC 827, 832; *Coleambally Irrigation Mutual Co-operative Ltd v Federal Commissioner of Taxation* (2004) 139 FCR 115 ('*Coleambally Irrigation*').

⁸⁶ *The Bohemians Club v Acting Federal Commissioner of Taxation* (1918) 24 CLR 334, 337 per Griffith CJ ('*Bohemians Club*'); *Coleambally Irrigation*, above n 85.

⁸⁷ See, for example, *Bohemians Club*, above n 86; *Sydney Water Board*, above n 81; (1968) 18 TBRD Case T55. See also RD Giles, 'Mutuality in Income Tax Law: *British Broadcasting Corporation v Johns*' (1966) 5(2) *Sydney Law Review* 278.

common purpose is not income'.⁸⁸ Thus the characteristics of organisations that can access mutuality typically include that the organisation is carried on for the benefit of members collectively, not individually; that the members share a common purpose in which all participate, or are entitled to; and that the members have ownership and control of the common fund.⁸⁹ The ATO accepts that the business of an organisation to which the principle of mutuality applies can either be for a taxable purpose and therefore producing assessable income or for a non-taxable purpose, producing mutual receipts.⁹⁰

The ATO refers to receipts derived by the entity from dealings with members as 'mutual receipts'.⁹¹ As mutual receipts do not give rise to taxable income, any expenses incurred in deriving them are not deductible. In addition, where other expenses are incurred when dealing with members, these costs also cannot be claimed as deductions due to the mutuality principle.⁹² Where goods or services are provided to both members and non-members, revenue may have to be apportioned between that which is assessable and that which is not assessable.⁹³ Similarly with any expenses. The principle does not extend to include income that is derived from sources outside the members collectively. Examples are bank interest and leasing of facilities to a single member for their exclusive use.⁹⁴

As the concept of mutuality was developed by the courts, common law countries are more likely to invoke the principle. Through much of the 20th century, the United Kingdom governments have grappled with the dichotomous controversy with arguments that co-operative dealings were indistinguishable from ordinary business dealings, countered with arguments that it was unfair to extend an income tax to tax what was not, at common law, income.⁹⁵

Australia has been far more accepting of the principle.⁹⁶ The Review of Business Taxation recommended '[t]hat the current common law exclusion from the calculation of taxable income of "mutual gains" – being gains by certain mutual entities and organisations from some dealings with their members – be given explicit effect in the tax law', rather than being left to the common law.⁹⁷ Following the Full Federal Court's

⁸⁸ ATO, 'Income Tax: How Should a Licensed Club Apportion Expenses When Calculating Its Taxable Income?', Taxation Determination TD 93/194 (7 October 1993) [1] ('TD 93/194').

⁸⁹ ATO, 'Mutuality and Taxable Income for Not-for-Profits' (NAT 73436, 4 December 2018) ('Mutuality and Taxable Income for Not-for-Profits').

⁹⁰ *Ibid.*

⁹¹ *Ibid.*

⁹² *Ibid.*

⁹³ *RACV*, above n 80.

⁹⁴ ATO, 'Mutuality and Taxable Income for Not-for-Profits', above n 90.

⁹⁵ Report of the Royal Commission on the Income Tax [1920] (UK) as set out in AM Carr-Saunders, PS Florence and R Peers, *Consumers' Co-operation in Great Britain* (1938) quoted in Edward James Stewart Chambers, 'Should the Earnings of Co-operative Associations Be Made Subject to the Federal Income Tax?' (MA Thesis, University of British Columbia, 1947) 88; Committee on the Present Position of Co-operative Societies in Relation to Income Tax (WN Raeburn, chair) (1933); United Kingdom, *Parliamentary Debates*, House of Commons, 12 May 1932, vol 265, cols 2072–73 (Neville Chamberlain, Chancellor of the Exchequer); United Kingdom, *Parliamentary Debates*, House of Commons, 22 May 1933, vol 278, cols 770–71 (Neville Chamberlain, Chancellor of the Exchequer), cols 781–83 and 1222–43 (Sir Stafford Cripps).

⁹⁶ Lyons and Passey, above n 10.

⁹⁷ Recommendation 5.6 of the Review of Business Taxation (John Ralph, chair), *A Tax System Redesigned: More Certain, Equitable and Durable* (July 1999), reported in Australian Competition and Consumer

decision in *Coleambally Irrigation Mutual Co-operative Ltd v Commissioner of Taxation*,⁹⁸ which held that an entity that could not distribute surplus was not a mutual entity, the *Income Tax Assessment Act 1997* (ITAA 1997) was amended to ensure that the mutuality principle, ‘a long established principle in tax law’, was retained.⁹⁹

In the past, attempts by the Commissioner to dispel the mutuality principle have failed. Submissions that (1) there is no place for the mutuality principle in the Income Tax Assessment Act and (2) that the mutuality principle is confined solely to the field of insurance¹⁰⁰ were summarily dismissed by the High Court in *Sydney Water Board Employees’ Credit Union Ltd v Federal Commissioner of Taxation (Sydney Water Board)* as being ‘inconsistent with expressions of that principle’, that ‘where it has not been excluded by statutory provision, it still applies’ and that the notion of being confined to insurance ‘is opposed to authority and must be rejected’.¹⁰¹

4.1.4 Tax incentives

Tax incentives may take the form of tax exemptions, tax deductions, tax rebates, reduced tax rates or deferred tax liability. There are many reasons why, as a matter of policy, co-operatives enjoy various tax incentives. These include being a catalyst to economic growth,¹⁰² such as through employment,¹⁰³ agricultural development,¹⁰⁴ or in support of general welfare.¹⁰⁵ Co-operatives are also seen as a means of promoting food security¹⁰⁶ and assisting in alleviating poverty.¹⁰⁷

Tax incentives for co-operatives are not uniformly provided across all countries and, for those countries that do provide tax incentives, they are not necessarily consistently applied across all co-operatives. The use of tax incentives to ‘acknowledge the importance of cooperatives to the economy’ was the subject of a study in the Philippines

Commission, *Report to the Treasurer on the Relative Financial and Corporate Differences Between Friendly Society Dispensaries and Pharmacist-Owned Pharmacies* (October 2002) 33–34.

⁹⁸ *Coleambally Irrigation*, above n 85.

⁹⁹ Explanatory Memorandum to the Tax Laws Amendment (2005 Measures No 6) Bill 2005, [2.2].

¹⁰⁰ *Sydney Water Board*, above n 81, discussed at 455 per Mason J.

¹⁰¹ *Ibid* 457 per Mason J.

¹⁰² E Kireyeva, ‘Tax Regulation in Agriculture: Current Trends, Selection of a State Support Forms’ (2016) 2(3) *Journal of Tax Reform* 179.

¹⁰³ Francisco Sancho, Luis Rivera and Julio Rosales, ‘Housing Finance in Central America: What Is Holding It Back?’ (Inter-American Development Bank Working Paper No IDB-TN-285, January 2012); Gökçen Özdemir, ‘Good Governance in Sustainable Human Development: A Subnational Case in Turkey’ (PhD Thesis, Middle East Technical University, 2013).

¹⁰⁴ Devendra Gauchan and Shreemat Shrestha, ‘Agricultural and Rural Mechanisation in Nepal: Status, Issues and Options for Future’ in MA Sattar Mandal, Stephen D Biggs and Scott E Justice (eds), *Rural Mechanisation: A Driver in Agricultural Change and Rural Development* (Institute for Inclusive Finance and Development, 2017); Poonam Gupta, ‘Generating Larger Tax Revenue in South Asia’ (MPRA Paper 61443, January 2015).

¹⁰⁵ Leopoldo Blugerman, Adrián Darmohraj and Mariana Lomé, ‘Social Enterprises in Argentina’ (Country Report, Social Enterprises on the Move, 2017).

¹⁰⁶ Shaikh Tanveer Hossain, ‘Impacts of COVID-19 on the Agri-Food Sector: Food Security Policies of Asian Productivity Organization Members’ (2020) 15(2) *Journal of Agricultural Sciences – Sri Lanka* 116; Vishwas Satgar, ‘Challenging the Globalized Agro-Food Complex: Farming Cooperatives and the Emerging Solidarity Economy Alternative in South Africa’ (2011) 14(2) *WorkingUSA* 177.

¹⁰⁷ Master Mushonga, Thankom G Arun and Nyankomo W Marwa, ‘Drivers, Inhibitors and the Future of Co-operative Financial Institutions: A Delphi Study on South African Perspective’ (2018) 133 *Technological Forecasting and Social Change* 254; Manuel Larrabure, Marcelo Vieta and Daniel Schugurensky, ‘The “New Cooperativism” in Latin America: Worker-Recuperated Enterprises and Socialist Production Units’ (2011) 43(2) *Studies in the Education of Adults* 181.

covering 56 countries.¹⁰⁸ In Europe, North America and Oceania – overwhelmingly developed countries – only France provides a full exemption. Canada, Germany and Ukraine have no exemptions. For those with selective and/or partial exemptions, policies generally target issues such as increasing financing flexibility¹⁰⁹ or climate change initiatives¹¹⁰ although agribusiness does feature.¹¹¹ Of the 24 Asian countries considered, six granted full exemptions¹¹² and another 14 provided exemptions either according to specific co-operative types or at reduced rates. The sector most favoured for tax incentives was the agricultural sector with a focus on strengthening food security and nutrition.¹¹³ In Africa, only Egyptian and Nigerian co-operatives, other than financial co-operatives, have full income tax exempt status.¹¹⁴ To that end it has been noted that ‘[t]he taxation of cooperatives appears to be a topic that is neglected in policies’.¹¹⁵ Only four South American countries were considered. Of these, two were exempt from profit tax in full while the other two enjoy conditional exemptions. Their reasons vary: for Venezuela, the policy objective for full exemption was said to be poverty reduction,¹¹⁶ in Argentina the full exemptions were based on the provision for general welfare by co-operatives,¹¹⁷ while redistribution of wealth was the focus in Brazil.¹¹⁸ On the other hand, in Mexico the intention of tax exemptions was said to be to increase the profit margins of co-operatives.¹¹⁹

Therefore, where co-operatives enjoy some form of tax incentive, there is generally a clear public policy rationale for them, for example encouraging food production. However, policies can change over time and what was considered good policy in the past may no longer be desirable. Further, the types of tax incentives vary between different types of co-operatives, and they also may only apply to certain or selective types of co-operatives.

¹⁰⁸ Ma Belinda S Mandigma and Blesilda P Badoc-Gonzales, ‘Tax Exemptions of Cooperatives in the Philippines and in Other Countries: A Comparative Study’ (2022) 11(2) *Review of Integrative Business and Economic Research* 144, 144.

¹⁰⁹ Jarka Chloupková, ‘European Cooperative Movement – Background and Common Denominators’ (Royal Veterinary and Agricultural University Unit of Economics Working Paper 2002/4, 2002).

¹¹⁰ Thomas Bauwens, Boris Gotchev and Lars Holstenkamp, ‘What Drives the Development of Community Energy in Europe? The Case of Wind Power Cooperatives’ (2016) 13 *Energy Research and Social Science* 136.

¹¹¹ Chloupková, above n 109; Jan Brusselaers, Krijn Poppe and Tomas Garcia Azcarate, ‘Do Policy Measures Impact the Position and Performance of Farmers’ Cooperatives in the EU?’ (2014) 85(4) *Annals of Public and Cooperative Economics* 531.

¹¹² These are India, Mongolia, Philippines, South Korea, Thailand, Tajikistan.

¹¹³ Hossain, above n 106; Maria Cristina F Melo, ‘Organic Rice Production and Consumption to Sustain Food Security in Oriental Mindoro, Philippines’ (2021) 10(S3) *Review of Integrative Business and Economics Research* 338.

¹¹⁴ Mandigma and Badoc-Gonzales, above n 108.

¹¹⁵ Jan Theron, ‘Cooperative Policy and Law in East and Southern Africa: A Review’ (Coop Africa Working Paper No 18, International Labour Organization, 2010) 18.

¹¹⁶ Larrabure, Vieta and Schugurensky, above n 107.

¹¹⁷ Blugerman, Darmohraj and Lomé, above n 105.

¹¹⁸ Tarcisio Pedro Da Silva, Mauricio Leite, Jaqueline Carla Guse and Vanderlei Gollo, ‘Financial and Economic Performance of Major Brazilian Credit Cooperatives’ (2017) 62(5) *Contaduría y Administración* 1442.

¹¹⁹ Mauricio Ramirez-Rodríguez and Luis César Almendárez-Hernández, ‘Subsidies in the Jumbo Squid Fishery in the Gulf of California, Mexico’ (2013) 40 *Marine Policy* 117.

4.2 Taxation of co-operatives in Australia

Income tax is payable by companies,¹²⁰ which include corporate or unincorporated bodies.¹²¹ In the absence of a special regime, co-operatives would be taxed as companies.

A specific taxing regime is provided for co-operatives that meet certain criteria. If the requirements cannot be met, it is necessary to consider whether or not the general tax provisions for companies apply. If the general provisions apply it will also be necessary to consider the provisions dealing with not-for-profit organisations and to consider the principle of mutuality.

4.2.1 Co-operative provisions

Specific provisions regarding the taxation of co-operatives are contained in Division 9 of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936). The consequence of the specific provision is that the principle of mutuality has been displaced.¹²²

A co-operative is defined very differently for tax purposes than for legal (regulatory) purposes. For tax purposes, a 'co-operative company' is defined to mean a company (defined as a body corporate or any other unincorporated association of body of persons¹²³ but explicitly excluding a friendly society dispensary and a credit union) that may or may not have share capital and is established specifically to carry on a business (the business requirement) with the object of:

- (a) the acquisition of commodities or animals for disposal or distribution among its shareholders;
- (b) the acquisition of commodities or animals from its shareholders for disposal or distribution;
- (c) the storage, marketing, packing or processing of commodities of its shareholders;
- (d) the rendering of services to its shareholders;
- (e) the obtaining of funds from its shareholders for the purpose of making loans to its shareholders to enable them to acquire land or buildings to be used for the purpose of residence or of residence and business.¹²⁴

If the co-operative has share capital, there are further requirements in that the number of shares per shareholder is limited (the ownership requirement) and the listing of securities on the stock exchange is prohibited.¹²⁵ These requirements regarding the

¹²⁰ ITAA 1997, above n 75, s 4-1.

¹²¹ Ibid s 9-1 item 2, s 995-1(1) 'company'.

¹²² *Sydney Water Board*, above n 81, 457 per Mason J.

¹²³ ITAA 1936, above n 76, s 6 read with ITAA 1997, above n 75, s 995-1 (definition of 'company').

¹²⁴ ITAA 1936, above n 76, s 117(1).

¹²⁵ Ibid.

entity's business and primary objects are to be considered 'at the time when the question whether or not it is to be treated as a co-operative company has to be determined'.¹²⁶

Notwithstanding that a co-operative may meet all these requirements, it will nevertheless fail to be a co-operative, for tax purposes, if its dealings with members is less than 90 per cent of its total dealings.¹²⁷ In other words, where non-members account for more than 10 per cent of the goods or services provided, the entity will not be a co-operative for tax purposes. Where two or more of the objects or purposes are being carried on, the amount attributed to each object must be considered individually to determine whether the 90 per cent threshold has been exceeded.¹²⁸ This business test is an integrity measure, guaranteeing that, while trading with non-members does occur, this is more the exception than the rule thus ensuring that the essence of a co-operative is not compromised.

A co-operative's assessable income includes all income received, whether from members or non-members and whether on account of the co-operative or on account of its members.¹²⁹ However, any assessable income that is distributed to members either by way of rebates or bonuses according to their involvement in the co-operative or that is distributed to members in accordance with their shares, is deductible.¹³⁰ This ensures effectively flow-through taxation.¹³¹ Taylor expressed the tax provisions, aimed at distributions by co-operatives to members, as being, 'in effect, a statutory substitute for the mutuality principle'.¹³²

Co-operative companies whose primary object is the acquisition of commodities or animals from their members for disposal or distribution can also claim a deduction for repayments of certain government and non-government loans.¹³³ These are loans for the purchase of assets to carry on the business of the co-operative. The deduction is allowed only if 90 per cent or more of the value of the co-operative is held by members who supply the co-operative with the commodities or animals.¹³⁴ As noted by Taylor, '[i]n the past this provision has assisted these co-operatives in retaining profits equal to the loan repayments as the deductibility of the loan repayments offset the tax payable on the retained profits'.¹³⁵ Because the repayment of the principal on a loan is generally not deductible, this constitutes a tax concession only available to co-operatives. However, no estimate of the cost of this concession (tax benchmark variation) pertaining to repaying these loans is available.¹³⁶

A further concession for co-operatives that meet the requirements of this Division is that any distributions made within three months of the end of the year of income can be

¹²⁶ *Renmark Fruitgrowers Co-operated Ltd v Federal Commissioner of Taxation* (1969) 121 CLR 501, 506 per Menzies J (*Renmark*). See also *Brookton Co-operative Society Limited v Federal Commissioner of Taxation* (1981) 147 CLR 441, 445 per Gibbs CJ, 461 per Aickin J.

¹²⁷ ITAA 1936, above n 76, s 118.

¹²⁸ *Renmark*, above n 126, 507 per Menzies J.

¹²⁹ ITAA 1936, above n 76, s 119.

¹³⁰ *Ibid* s 120(1)(a)-(b). See also *Ardmona Fruit Products Co-operative Co Ltd v Federal Commissioner of Taxation* (1952) 86 CLR 530, 534.

¹³¹ Thank you to the anonymous referee for this insight.

¹³² Taylor, 'Reform of Co-operative Legislation', above n 63, 111.

¹³³ ITAA 1936, above 76, ss 120(1)(c), 120(3).

¹³⁴ *Ibid* s 120(1).

¹³⁵ Taylor, 'Reform of Co-operative Legislation', above n 63, 112.

¹³⁶ Australian Treasury, *Tax Expenditures and Insights Statement* (January 2024) 103.

attributed to the preceding income year.¹³⁷ Thus, if eligible under Division 9, the co-operative is entitled to a tax deduction for patronage rebates, bonuses or dividends on shares paid to members based on business transacted with members. Some agricultural producer co-operatives may also be entitled to deductions for capital repayments on certain loans.

While these provisions may appear straightforward, their application is complex. This is because they apply only to some types of co-operatives and only in certain circumstances. In addition, they will only apply in a financial year where the 'business' and 'ownership' requirements are met.

4.2.2 *Company tax provisions*

The general provisions of the ITAA 1997 are relevant to co-operative companies in a number of ways. For example, the rules relating to imputation may apply. This means that instead of claiming the distributions to members as deductions, the entity may pass on franking credit for tax paid by the entity. However, the imputation system only applies to co-operatives with a share capital. That is, to distributing co-operatives and those non-distributing co-operatives who have elected to have share capital. Thus, co-operatives that are registered as companies in Australia will be taxed as companies. This includes all financial co-operatives.¹³⁸

If Division 9 of the ITAA 1936 does not apply, and the co-operative does not have a share capital, the co-operative is prima facie taxed as a company, ie, entity taxation applies. It is also necessary to consider whether the entity may be a not-for-profit company.

4.2.3 *Not-for-profit company*

If an entity is not-for-profit this may impact its liability to tax. The tax law does not define the term 'not-for-profit'. The ATO describes a not-for-profit organisation as 'a company that is not carried on for the purposes of profit or gain to its individual members [and] its constituent documents must prohibit it from making any distribution'.¹³⁹ That is, any profit made goes back into the operation of the organisation to carry out its purposes.

There are three types of not-for-profits: charities, other exempt and taxable. In the tax law, certain entities are exempt from income tax irrespective of the type of income they receive.¹⁴⁰ These include registered charities,¹⁴¹ and entities that are exempt (ie, eight groups of entities that require an organisation to self-assess whether entitled to exemption).¹⁴²

¹³⁷ ITAA 1936, above n 76, s 120(6).

¹³⁸ Apps, 'Legislating for Co-operative Identity', above n 6.

¹³⁹ ATO, 'Mutuality and Taxable Income for Not-for-Profits', above n 89; see also ATO, 'Definitions' (Web Page, 30 May 2023) <<https://www.ato.gov.au/using-our-website/definitions#N>>.

¹⁴⁰ ITAA 1997, above n 75, s 11-5.

¹⁴¹ Registered with the Australian Charities and Not-for-profits Commission and endorsed by the ATO as income tax exempt. *Australian Charities and Not-for-profits Commission Act 2012* (Cth) s 30-20 and ITAA 1997, above n 75, s 50-5.

¹⁴² These are community service organisations, cultural organisations, educational organisations, employment organisations, health organisations, resource development organisations, scientific organisations and sporting organisations: ITAA 1997, above n 75, Div 50, ss 50-5 to 50-40.

In *Commissioner of Taxation v Co-operative Bulk Handling Limited*,¹⁴³ the majority in the Full Federal Court held that the test for exemption is what the entity does and why it does it.¹⁴⁴ If the ‘what’ refers to an activity for the sole or dominant purpose of one of the exempt categories and the ‘why’ refers to not being for the profit or gain of its individual members, then that is sufficient to qualify for an exemption from tax. Specifically,

The focus must be upon the periodic or recurrent purposes of the body in the year of income. The formal objects or purposes for which the body was incorporated may also be considered but taken alone will not be determinative.¹⁴⁵

In that case, the Full Federal Court accepted that CBH was exempt under section 50-40 of the ITAA 1997 (ie, established for the purpose of promoting the development of agriculture resources) and was not carried on for the profit of individual members, despite the entity making significant distributions to members.¹⁴⁶ Despite this, within a few years CBH was granted charitable entity status and is now registered as such with the Australian Charities and Not-for-profits Commission.¹⁴⁷

If the co-operative is not a registered charity and does not come within one of the eight exempt groups, then it is considered to be taxable. For income tax purposes, an entity could be either a ‘non-profit company’ or ‘other taxable company’.¹⁴⁸ ‘Other taxable companies’ are taxed on every dollar of taxable income whereas ‘non-profit companies’ have a tax-free threshold (AUD 416), are subject to special rates of tax and have special arrangements for lodging tax returns.¹⁴⁹

A ‘non-profit company’ is defined to mean a company that is not carried on for the purposes of profit or gain to its individual members and is, by the terms of the company’s constituent document, prohibited from making any distribution, whether in money, property or otherwise, to its members.¹⁵⁰ However, the 1936 income tax legislation makes no reference to non-profit companies while the references in the 1997 income tax legislation have very specific application such as the 2019 flood recovery grants,¹⁵¹ in relation to marriage education,¹⁵² and special rules dealing with ownership of companies.¹⁵³

¹⁴³ *Federal Commissioner of Taxation v Co-operative Bulk Handling Limited* (2010) 189 FCR 322, per Mansfield and McKerracher JJ (Siopis J dissenting) (‘*Co-operative Bulk Handling*’).

¹⁴⁴ *Ibid* [114] per Mansfield and McKerracher JJ.

¹⁴⁵ *Ibid* [15] per Mansfield and McKerracher JJ.

¹⁴⁶ *Co-operative Bulk Handling*, above n 143.

¹⁴⁷ ACNC, above n 16. Thank you to the anonymous referee for this insight.

¹⁴⁸ ATO, ‘Not-for-Profit Organisations’ (QC 33560, 7 April 2017).

¹⁴⁹ ATO, ‘Lodgement Rules and Tax Rates’ (QC 23099, 4 December 2018) <<https://www.ato.gov.au/businesses-and-organisations/not-for-profit-organisations/your-organisation/in-detail/income-tax/mutuality-and-taxable-income-for-not-for-profits/lodgment-rules-and-tax-rates>>.

¹⁵⁰ *Income Tax Rates Act 1986* (Cth) s 3.

¹⁵¹ ITAA 1997, above n 75, s 59-85

¹⁵² *Ibid* s 30-70

¹⁵³ *Ibid* ss 165-12, 165-37, 165-115C, 165-115L, 165-123.

4.2.4 Mutuality

An entity such as a co-operative may be able to apply the principle of mutuality in calculating their tax liability. Here the issue is not the classification of the entity but rather the characterisation of the entity's receipts.

Mutuality is concerned with a mutual arrangement or relationship. For a co-operative, this relationship is with members. Dealings with non-members can never be considered a mutual arrangement or relationship. However, where dealings go beyond a mutual arrangement and are in the nature of trade, then the fact that the co-operative is dealing with a member is irrelevant – the mutuality principle does not apply.¹⁵⁴

The definition of 'business' includes carrying on a trade.¹⁵⁵ To assist businesses in determining whether a business or trade is being carried on, the ATO has issued a public ruling that comprises a set of indicators as developed by the courts.¹⁵⁶ The ATO accepts that 'the capacity to earn and distribute profits need not be present before an activity of a [not-for-profit] entity has the form of a business'.¹⁵⁷ Thus, if a business or trade is being carried on, the co-operative may have a taxable purpose that produces assessable income, a non-taxable purpose that produces mutual receipts or a combination of both.

In *Fletcher v Income Tax Commissioner*,¹⁵⁸ Lord Wilberforce explained:

In other cases, there may be in some sense a trading activity, but the objective, or the outcome, is not profits, it is merely to cover expenditure and to return any surplus, directly or indirectly, sooner or later, to the members of the group. These two criteria often, perhaps generally, overlap; since one of the criteria of a trade is the intention to make profits, and a surplus comes to be called a profit if it derives from a trade. So the issue is better framed as one question, rather than two: is the activity, on the one hand, a trade, or an adventure in the nature of trade, producing a profit, or is it, on the other, a mutual arrangement which, at most, gives rise to a surplus?¹⁵⁹

Although aspects of a co-operative's activities may generate mutual receipts, that does not mean that all its receipts, even those from members, are covered by the principle of mutuality.¹⁶⁰ For example, in the *Sydney Water Board* case it was held that the interest paid by individual members on borrowings from their credit union were not contributions by those members to a common fund but simply the cost of obtaining their individual loans.¹⁶¹ Similarly, fees paid by the organisers of a trade fair to an association were held not to be fees payable by the members of the association into a common fund as the purpose of the fair was to facilitate trading for profit by individual traders.¹⁶² But determining whether a trade or a mutual arrangement is occurring is not necessarily

¹⁵⁴ ATO, 'Mutuality and Taxable Income for Not-for-Profits', above n 89.

¹⁵⁵ ITAA 1997, above n 75, s 995-1.

¹⁵⁶ ATO, 'Income Tax: Am I Carrying On a Business of Primary Production?', Taxation Ruling TR 97/11 (16 November 2011).

¹⁵⁷ ATO, 'Mutuality and Taxable Income for Not-for-Profits', above n 89.

¹⁵⁸ *Fletcher v Income Tax Commissioner* [1972] AC 414.

¹⁵⁹ Ibid 421. See also *Municipal Mutual Insurance Ltd v Hills* (1930) 16 TC 430, 441 per Viscount Dunedin and *Federal Commissioner of Taxation v Australian Music Traders Association* [1990] FCA 192 [4].

¹⁶⁰ *Sydney Water Board*, above n 81; *RACV*, above n 80.

¹⁶¹ *Sydney Water Board*, above n 81.

¹⁶² *Commissioner of Taxation v Australian Music Traders Association* [1990] FCA 192.

straightforward. The ATO provides an example of each. Sales to members from a bar, provided for the benefit of all members, is a mutual arrangement; ‘leasing a club facility to a member for their individual benefit ... is in the nature of a trade’.¹⁶³ But what of a food co-operative that sells fresh and preserved groceries and other household products? Are the sales to members a mutual arrangement or in the nature of a trade? There is no requirement that, to be a mutual receipt, sales must be at cost as the ATO acknowledges that even if sold at a profit, ‘the revenue would also be classified as mutual receipts’.¹⁶⁴

Where a co-operative engages in trade with both members and non-members, and where expenses are incurred, it will be necessary to apportion receipts and expenses.

4.2.5 Apportionment

Differentiating between types of revenue adds significant compliance costs. Apportioning between income that is assessable and that which is not requires reliable systems, processes, procedures and policies, and the clear definition on whether the target entity is dealing with a member or non-member. There are a number of methods available and the method, or methods, chosen must reasonably and accurately reflect the co-operative’s revenue and expenses. Where revenue but not expenses can be readily identifiable as coming from members or non-members, the simple method is appropriate.¹⁶⁵ Typically this is recorded by members signing in any guests or the entity recording when a non-member uses the facilities. Here the ratio of members to non-members income is applied to revenue as a single percentage to determine the quantum of member and non-member revenue.

The application, however, is not always as simple. *Royal Automobile Club of Victoria v Federal Commissioner of Taxation*¹⁶⁶ concerned a number of activities. Anderson J was of the opinion that, notwithstanding the complexity or diversity of activities, the principle remained, concluding that ‘[j]ust as some of the activities of the one organization may be mutual and some not, so also some dealings in relation to an activity may be mutual and some not’.¹⁶⁷ While the revenue attributable to each of the activities was readily ascertainable, the costs were not due to the ‘cross services’, requiring ‘an examination of each head of cost and appropriate allocation’, leading to the conclusion that ‘while there may be room for differences of opinion as to particular items of cost, what is involved are principles of accountancy rather than principles of law’.¹⁶⁸

An apportionment methodology accepted as a reasonable basis, particularly for registered and licensed clubs, is referred to by the ATO as ‘the Waratahs formula’.¹⁶⁹ It

¹⁶³ ATO, ‘Mutuality and Taxable Income for Not-for-Profits’, above n 89.

¹⁶⁴ Ibid.

¹⁶⁵ Ibid.

¹⁶⁶ *RACV*, above n 80.

¹⁶⁷ Ibid 572, referring also to *Carlisle and Silloth Golf Club v Smith* [1913] 3 KB 75.

¹⁶⁸ *RACV*, above n 80, 579.

¹⁶⁹ The reference to the formula suggests it is derived from the case of *“The Waratahs” Rugby Union Football Club Ltd v Federal Commissioner of Taxation* (1979) 10 ATR 33. See ATO, ‘Mutuality and Taxable Income for Not-for-Profits’, above n 89; ATO, ‘Waratahs Formula’ (Web Page, last updated 4 December 2018) <<https://www.ato.gov.au/businesses-and-organisations/not-for-profit-organisations/your-organisation/in-detail/income-tax/mutuality-and-taxable-income-for-not-for-profits/separating-apportionable-items/waratahs-formula>>. See also ATO, TD 93/194, above n 88, re apportionment of expenses.

applies where the separation of apportionable revenue and expenses is more involved, and simplifies the process for separating expenses that cannot be easily identified as either member or non-member. This method calculates the ‘non-member percentage’, which is then applied to the entity’s revenue and expenses to arrive at the assessable and deductible components.¹⁷⁰ However, the formula requires a differentiation to be made between members, on the one hand, and members’ guests and other visitors (non-members) on the other hand. While clubs and some associations maintain daily registers, co-operatives generally do not. Much depends on the degree of sophistication of the systems, such as point-of-sale, used by each co-operative. As an alternative, the ATO recommends ‘a minimum of two one-week surveys be done each year’,¹⁷¹ further increasing complexity, ambiguity and hence compliance costs. Further, because of the variability in the components of the Waratahs formula, this apportionment method will have to be calculated each financial year.

A third apportionment method is available but requires the co-operative to negotiate a percentage with the ATO.¹⁷² This is the fixed percentage method and will only apply so long as there are no material changes in circumstances. What is considered a ‘material change’ is not stated in the ATO’s guide.

4.2.6 Tax rate

If taxable income exceeds AUD 416 in any financial year, a co-operative is required to lodge a company tax return for that year. This threshold is considered very low, not having been changed for several decades.¹⁷³ While a recommendation was made to raise this to AUD 10,000, this has not, to date, eventuated.¹⁷⁴

The tax rate to apply depends on whether the co-operative is a ‘base rate entity’ (25 per cent rate) or not (30 per cent rate). This requires assessment of aggregate turnover to a turnover threshold and ratio of active (trading) to passive (interest, dividends, rent) assessable income.¹⁷⁵ If the requirements of being a base rate entity are met, the lower tax rate applies (currently 25 per cent). Base rate entity passive income only includes assessable income that is legislatively specified.¹⁷⁶ Therefore mutual receipts being non-assessable, non-exempt income are excluded. But mutual receipts are not excluded from turnover calculations.¹⁷⁷

4.3 International comparisons

The taxation of co-operatives internationally is varied. The issue of mutual receipts is similar, yet the perspectives taken are different.

¹⁷⁰ ATO, ‘Mutuality and Taxable Income for Not-for-Profits’, above n 89.

¹⁷¹ Ibid.

¹⁷² Ibid.

¹⁷³ See, for example, Community Sector Banking, Submission to NFP Tax Concessions Discussion Paper (The Treasury); Moore Stephens, Submission to the Discussion Paper: Not-For-Profit Sector Tax Concessions Working Group (The Treasury) (14 December 2012).

¹⁷⁴ Not-for-Profit Sector Tax Concession Working Group (Linda Lavarch, chair), *Fairer, Simpler and More Effective Tax Concessions for the Not-for-Profit Sector: Final Report* (May 2013); Danielle Kutchel, ‘Exclusive: “Unfinished Business” for Not for Profit Tax System’, *Pro Bono Australia* (17 August 2022).

¹⁷⁵ *Income Tax Rates Act 1986* (Cth), above n 150, s 23AA.

¹⁷⁶ Ibid s 23AB.

¹⁷⁷ ATO, ‘Mutuality and Taxable Income for Not-for-Profits’, above n 89, above n 89.

4.3.1 United Kingdom

In the United Kingdom the principle of mutuality has been at the core of the development of the taxation of co-operatives. However, this has been progressively eroded to the point now where co-operatives are considered companies for tax purposes, liable to corporation tax computed in accordance with the rules pertaining to companies. Mutuality is still recognised but in specified circumstances.¹⁷⁸ Provided the calculation of certain sums that constitute the profit meet certain criteria¹⁷⁹ and the co-operative only has a relationship with members, those sums are excluded from the calculation of profits.¹⁸⁰ In addition, if a distribution is made to members, whether that distribution comes from the surplus of trading with members or with non-members must be established as distributions out of a mutual surplus give rise to taxable receipts whereas distributions out of taxable income give rise to non-taxable receipts.¹⁸¹

The basis of the taxation treatment of mutual trading is *Ayrshire Employers Mutual Insurance Association Ltd v Commissioners of Inland Revenue*.¹⁸² The decision shows that it is not the fact of membership or non-membership that determines exemption from or liability to tax. It is the nature of the transactions themselves which is the case in Australia. If the transactions are in the nature of mutual trading the resulting surplus is not taxable. But the transactions can only amount to mutual trading if the contributors are members who are entitled to a return of their share of the surplus contributions.

4.3.2 United States

The position in the United States is very different. While most provisions in the *Internal Revenue Code* apply to co-operatives on the basis that they conduct business, Subchapter T¹⁸³ specifically relates to co-operatives. It applies to 'any corporation operating on a cooperative basis', without defining 'cooperative' or 'operating on a cooperative basis'. It has been held to include non-farming businesses such as co-op grocery stores,¹⁸⁴ hardware stores,¹⁸⁵ and service providers.¹⁸⁶ The benefit of qualifying as a co-operative is access to single tax treatment (flow-through taxation) where the patron or member, rather than the co-operative, pays the tax.¹⁸⁷ Earnings from sources

¹⁷⁸ For example, there is specific statutory confirmation of the non-application of the mutuality principle to property income: *Corporation Tax Act 2009* (UK) s 260 for corporation tax and *Income (Trading and Other Income) Act 2005* (UK) s 321 for income tax.

¹⁷⁹ These are: (1) that contributors to and participants in a surplus must be identical; (2) that the surplus must go back to contributors; (3) that surplus contributions must be returned, and (4) that members control the co-operative.

¹⁸⁰ *Corporation Tax Act 2009* (UK), above n 178, s 132.

¹⁸¹ *Corporations Tax Act 2010* (UK) s 1070.

¹⁸² *Ayrshire Employers Mutual Insurance Association Ltd v Commissioners of Inland Revenue* [1946] 27 TC 331.

¹⁸³ Internal Revenue Code ss 1381-1388 covering determining qualifying co-operatives, definitions of key co-operative tax terms, how taxable income is calculated and also addresses patron taxation. In addition, s 521 provides an exemption of farmers' co-operatives from tax.

¹⁸⁴ *Certified Grocers of California, Ltd v Commissioner*, 88 TC 238 (1987); *Twin County Grocers, Inc v United States*, 2 Cl Ct 657 (1983); and *United Grocers, Ltd v United States*, 308 F.2d 634 (9th Cir 1962), aff'g, 186 F. Supp 724.

¹⁸⁵ *Cotter and Co v United States*, 765 F.2d 1102 (Fed Cir 1985), rev'g, 6 Ct Cl 219 (1984).

¹⁸⁶ *Washington-Oregon Shippers Cooperative, Inc v Commissioner*, 52 TCM (CCH) 1406 (1987).

¹⁸⁷ *Puget Sound Plywood, Inc v Commissioner* (44 TC 305, 307-308 [1965], acq 1966-1 CB 3); Frederick, above n 79, 8; Sofia Arana-Landin, 'US Worker Cooperatives: A Dire Need for a Profound Revision of Their Tax Regulation at a Federal Level' (2022) 4 *International Journal of Cooperative Law* 131, 150.

other than members are taxed in the co-operative. Surpluses not distributed are treated as if they had been distributed and re-invested. As a consequence, undistributed surpluses are taxed in the hands of the co-operative and later the patrons (members) when distributed.¹⁸⁸

Following a number of disputes over the meaning of ‘operating on a cooperative basis’, a revenue ruling was issued in 1972 effectively stating that, to qualify, the co-operative must do more than 50 per cent of its business with members.¹⁸⁹ This ruling was subsequently invalidated by the courts.¹⁹⁰ The revenue ruling was modified so that whether a corporation is operating on a cooperative basis ‘will be determined from all the facts and circumstances and the cooperative principles enunciated in *Puget Sound Plywood*’.¹⁹¹ The Court in *Puget Sound Plywood v Commissioner*¹⁹² listed ‘three guiding principles ... as the core of cooperative economic theory’, being: (1) limiting the financial return of capital; (2) democratic control by the members, and (3) allocation of margins (or surplus) on the basis of patronage.¹⁹³

It is important to note that incorporation as a co-operative under a state or federal law does not necessarily qualify that entity to apply Subchapter T of the *Internal Revenue Code*.¹⁹⁴ When considering if an entity is a co-operative, it is not the fact that it has been constituted or registered as such, but rather how it operates – that the entity acts on a cooperative basis.¹⁹⁵ The legal forms a co-operative can take are: corporations, limited liability companies, section 501(c) co-operatives, and exempt or section 521 entities and partnerships.¹⁹⁶ Thus, in the US, there are different choices of taxation depending on the legal form the entity, acting on a cooperative basis, takes. Consequently, there is no single special regime for all co-operatives but several, as different tax provisions may apply depending on the legal form chosen and how it operates.

4.3.3 European Union

In the European Union the focus has been on the balancing of Member State tax sovereignty with State Aid, ie, tax competition. As the basic law on the European Cooperative Society expressly excludes taxation,¹⁹⁷ this has allowed individual Member States to create specific tax regimes for their own co-operatives.¹⁹⁸ A constraining factor is the prohibition of State Aid.¹⁹⁹ The Court of Justice of the European Union has determined that tax exemptions, granted to co-operative societies, would only constitute

¹⁸⁸ Arana-Landin, above n 187, 150.

¹⁸⁹ United States Internal Revenue Service, Revenue Ruling, Rev Rul 93-21; 1993-1 CB 188; United States Internal Revenue Service, Revenue Ruling, Rev Rul 72-602, 1972-2 CB 511

¹⁹⁰ On the grounds that it added a quantitative requirement not intended by Congress. See, for example, *Conway County Farmers Association v United States*, 588 F.2d 595 (8th Cir 1978), rev’g 1978-1 USTC (CCH) and 9334 (ED Ark 1978); *Columbus Fruit and Vegetable Cooperative Association, Inc v United States*, 7 Cl Ct 561 (1985); *Geauga Landmark, Inc v United States*, No 81-942 (ND Ohio 1985).

¹⁹¹ United States Internal Revenue Service, Revenue Ruling 93-21, IRB 1993-1 CB 188, modifying Revenue Ruling 72-602, 1972-2 CB 510.

¹⁹² *Puget Sound Plywood, Inc v Commissioner*, 44 TC 305, 308 (1965), acq 1966-2 CB 6.

¹⁹³ Ibid 308 per Pierce J.

¹⁹⁴ Frederick, above n 79.

¹⁹⁵ Arana-Landin, above n 187.

¹⁹⁶ Ibid 131.

¹⁹⁷ European Council, Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society, [2003] OJ L 207/1 (as amended).

¹⁹⁸ Torralvo, above n 11.

¹⁹⁹ *Treaty on the Functioning of the European Union*, Art 107(1).

State Aid if they were selective and not justified by the nature or economy of the tax system.²⁰⁰ Consequently, in 2016, the European Commission drew up a Commission Notice on State Aid and Article 107.²⁰¹ Importantly, it was confirmed that economic activity, not legal status, defines undertakings as entities, meaning that '[t]he classification of a particular entity as an undertaking thus depends entirely on the nature of its activities'.²⁰² The Notice also specifically addressed co-operative societies. It held that, in light of their particular features (such as specific membership requirements, activities conducted for the mutual benefit of members, reserves and assets being non-distributable), co-operatives 'can be regarded as not being in a comparable factual and legal situation to that of commercial companies'.²⁰³

For co-operatives specifically, any exemption or special treatment requires 'an analysis of whether the tax regime in question is justified by the logic of the tax system',²⁰⁴ that is, its nature or general scheme.²⁰⁵ A tax exemption or reduced tax rate granted to a co-operative can, for example, be justified by the fact that all profit or surplus is distributed and subsequently taxed in the hands of the receiving members. Alternatively, as in Spain, Portugal and Italy, where it is seen as desirable to retain a percentage of the net revenue, tax provisions are used to achieve this by making a percentage of net revenue deductible.²⁰⁶ The justification is qualified in that 'the reduced taxation must be proportionate'²⁰⁷ and not go beyond what is necessary' and appropriate controls are implemented.²⁰⁸

4.3.4 Concluding comments

Australia and the United Kingdom distinguish mutual activities from non-mutual trading activities, giving rise to the need for apportionment, and both tax the entity. The United States, on the other hand employs flow-through taxation. It also takes the view that the entity is taxed as a corporation in the first instance unless it can establish itself as a co-operative whereas Australia's view is that, provided it does not have a share capital, being taxed as a corporation is more of a last resort.

The legal form is of no consequence in both the United Kingdom and United States. In the former all co-operatives are considered companies for tax purposes while in the latter the legal form is not a consideration at all. The European Union, on the other hand, adopts an either/or approach. In Australia co-operatives registered as companies and co-

²⁰⁰ *Paint Graphos and others* (Joined Cases C-78/08 to C-80/0) ECLI:EU:C:2011:550 (8 September 2011) [82].

²⁰¹ European Commission, *Commission Notice on the Notion of State Aid as Referred to in Article 107(1) of the Treaty on the Functioning of the European Union* [2016] OJ C 262/1 ('*Commission Notice on the Notion of State Aid*').

²⁰² *Ibid* [2.1]. See also *Pavlov and Others* (Joined Cases C-180/98 to C-184/98) ECLI:EU:C:2000:428 (12 September 2000) para 74; *Cassa di Risparmio di Firenze SpA and Others* (C-222/04) ECLI:EU:C:2006:8 (10 January 2006) para 107.

²⁰³ European Commission, *Commission Notice on the Notion of State Aid*, above n 201, [157] and [158].

²⁰⁴ *Ibid* [159].

²⁰⁵ Richard Lyal, 'Transfer Pricing Rules and State Aid' (2015) 38(4) *Fordham International Law Journal* 1017, 1032.

²⁰⁶ Arana-Landin, above n 187.

²⁰⁷ The principle of proportionality is laid down in Article 5(4) of the *Treaty on European Union* and seeks to set actions taken by European Union institutions within specified bounds which includes that the measure must be both suitable and necessary to achieve the desired end and must not impose a burden on the individual that is excessive in relation to the objective sought.

²⁰⁸ European Commission, *Commission Notice on the Notion of State Aid*, above n 201, [160].

operatives with a share capital are taxed as companies thereby differentiating non-distributing co-operatives without a share capital

The manner in which co-operatives are taxed in Australia, the United Kingdom and United States has in each case developed on an ad hoc basis, driven largely by developments in the principle of mutuality at common law. The consequence is that they all generally agree that proceeds from mutual trade distributed to members are not taxed and proceeds from trade with non-members are taxed. In the United States, this can give rise to double taxation when distributed while in Australia and the United Kingdom such amounts are excluded from the calculation of profit and hence the calculation of assessable income.

The European Union has taken a purposive approach, based on clear policy objectives. Here the courts consider the justification for any special treatment in accordance with the principle of proportionality laid down in the *Treaty on European Union*.²⁰⁹ However, this can result in piecemeal concessions that are not uniformly applied.

When it comes to the taxation of co-operatives, best practice is still illusive.

5. CONCLUSIONS

The 2012 International Year of Co-operatives, initiated by the United Nations, raised awareness of the important role of co-operatives in promoting sustainable development and contributing to economic development more generally. This contributed to also raising awareness of co-operatives as a viable business model that advances both social and economic development. The year 2025 has been proclaimed by the UN as the next International Year of Co-operatives.²¹⁰ The 2023 resolution also sought to draw governments' attention to the recommendations made in the UN Secretary-General's report, *Cooperatives in Social Development*, so as to support and strengthen co-operatives as successful business enterprises.²¹¹ One recommendation relates to improving laws and regulations with respect to, inter alia, taxation. The report particularly noted that co-operatives 'continue to play a relatively small part in overall economic and social policies and practice, compared with their huge potential contribution'.²¹²

If co-operatives are to be afforded differential tax treatment, this must be justifiable to avoid accusations of, or even suspicions of, favouring a position of unfair competition against companies operating in the 'open' market. It could be argued that the attributes of a co-operative – in particular the focus on social objectives – provide this justification.²¹³ A further recommendation suggested by John Taylor was to collect into

²⁰⁹ Article 5(4). See n 207 above.

²¹⁰ United Nations, General Assembly, *Resolution on Cooperatives in Social Development*, GA Res A/RES/76/135, UN Doc A/C.3/78/L.11 (10 October 2023, adopted 3 November 2023).

²¹¹ United Nations, *Cooperatives in Social Development: Report of the Secretary-General*, above n 47.

²¹² Ibid 13.

²¹³ See, for example, European Commission, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Building an Economy That Works for People: An Action Plan for the Social Economy*, COM/2021/778 final, 9 December 2021 ('An Action Plan for the Social Economy').

one Division of the income tax Act the ‘various provisions which govern the distribution of surpluses to members’.²¹⁴

Co-operatives are different from all other forms of business organisations. They have been termed the ‘enfants terribles’ of economics²¹⁵ as they are arguably too socially or community-oriented for mainstream business but too business-oriented for the not-for-profit sector. Perhaps they are better termed ‘social economy organisations’. The characteristics of co-operatives can assist in fostering more sustainable business models. Their participatory and democratic structures, collective decision-making, frequently multi-objective and multi-stakeholder nature, and their focus on social aspects are foundational characteristics that could prove to be fundamental for a paradigm shift in the prevailing operating models.²¹⁶

Recently, there has been a flurry of activity promoting the social economy/social enterprise model, with prominence given to co-operatives. For example, in 2023, the OECD released two policy guides²¹⁷ and nine thematic papers. This followed a 2022 manual and a number of policy briefs and in-depth country reviews on social entrepreneurship.²¹⁸ The European Commission provided an action plan for the social economy to the European Parliament, Council and other committees in 2021.²¹⁹ The International Labour Organization’s Recommendation 193 on the Promotion of Cooperatives, adopted in 2002 and updated in 2014, provides an internationally agreed template for national policy²²⁰ and the social and solidarity economy was a key feature of its 2022 conference.²²¹

On 19 June 2023 the UK government announced a review of the *Co-operative and Community Benefit Societies Act 2014*.²²² Apart from legislative changes, which entailed more of a consolidation of legislation rather than material changes to the law

²¹⁴ Taylor, ‘Reform of Co-operative Legislation’, above n 63, 112.

²¹⁵ Yair Levi and Peter Davis, ‘Cooperatives as the “Enfants Terribles” of Economics: Some Implications for the Social Economy’ (2008) 37(6) *The Journal of Socio-Economics* 2178.

²¹⁶ International Cooperative Alliance and Euricse, *World Cooperative Monitor: Exploring the Cooperative Community* (December 2021) 30; Marek Hudon and Benjamin Huybrechts, ‘From Distant Neighbours to Bedmates: Exploring the Synergies Between the Social Economy and Sustainable Development’ (2017) 88(2) *Annals of Public and Cooperative Economics* 141.

²¹⁷ OECD, *Policy Guide on Legal Frameworks for the Social and Solidarity Economy* (Local Economic and Employment Development Series, 20 March 2023); OECD, *Policy Guide on Social Impact Measurement for the Social and Solidarity Economy* (Local Economic and Employment Development Series, 20 March 2023).

²¹⁸ See OECD, ‘Social Entrepreneurship and Social Enterprises’ (Web Page, 2023) <<https://www.oecd.org/cfe/leed/social-economy/social-entrepreneurship.htm>>.

²¹⁹ European Commission, *An Action Plan for the Social Economy*, above n 213.

²²⁰ International Labour Organization, *Promoting Cooperatives: An Information Guide to ILO Recommendation No 193* (2014).

²²¹ International Labour Organization, ‘110th Session of the International Labour Conference’ (Web Page, 2022) <<https://www.ilo.org/ilc/ILCSessions/110/lang--en/index.htm>>.

²²² Andrew Griffith (Economic Secretary to the Treasury), ‘Law Commission Reviews of the Co-operative and Community Benefit Societies Act 2014 and Friendly Societies Act 1992’ (Treasury Ministerial Statement, 19 June 2023). At the time of writing, the Terms of Reference have not been released.

and which resulted in the 2014 Act,²²³ the last general review and reform of the law pertaining to co-operatives in the UK was reportedly undertaken in 1893.²²⁴

In 2016 an Australian Senate inquiry provided its report into co-operative, mutual and member-owned firms.²²⁵ Here the recommendations related to compiling statistical data to better understand the sector, developing support programs to encourage growth in the sector and ensuring co-operatives are better represented in government policy. While taxation was sporadically referred to, no express recommendations were made. Taxation is also not mentioned in the Australian Business Council of Co-operatives and Mutuals discussion paper, issued in August 2023, on the regulation of co-operatives,²²⁶ where the focus is on the Co-operatives National Law as a legislative framework, and uniformity in administration.

Historically, the debate about co-operatives has always been ideological more than technical. However, with an increased focus on sustainable development and the social economy, the co-operative business model provides a viable innovative and democratic alternative. Tax policy will become increasingly important as the use of co-operatives, as a business model, increases.

²²³ Mike Aiken et al, 'Social Enterprise in the UK: Models and Trajectories' in Jacques Defourny and Marthe Nyssens (eds), *Social Enterprise in Western Europe: Theory, Models and Practice* (Routledge, 2021) 253. See also Law Commission (UK), *Annual Report 2013-14* (Law Com No 352, 2014).

²²⁴ Co-operatives UK, 'Andrew Griffith MP Announces Government Review of Co-operative and Community Benefit Societies Act 2014 at Congress' (Web Page, last updated 19 June 2023) <<https://www.uk.coop/news/andrew-griffith-mp-announces-government-review-co-operative-and-community-benefit-societies>>.

²²⁵ Australian Parliament, Senate Economics References Committee, above n 12.

²²⁶ Business Council of Co-operatives and Mutuals, *Modernising Australian Co-operatives Regulation: Discussion Paper* (August 2023).