TR 2003/D13 - Income tax: Taxation treatment of volume rebates paid to a retailer association

This document has been finalised by TR 2004/5.

Draft Taxation Ruling

Income tax: Taxation treatment of volume rebates paid to a retailer association

Preamble

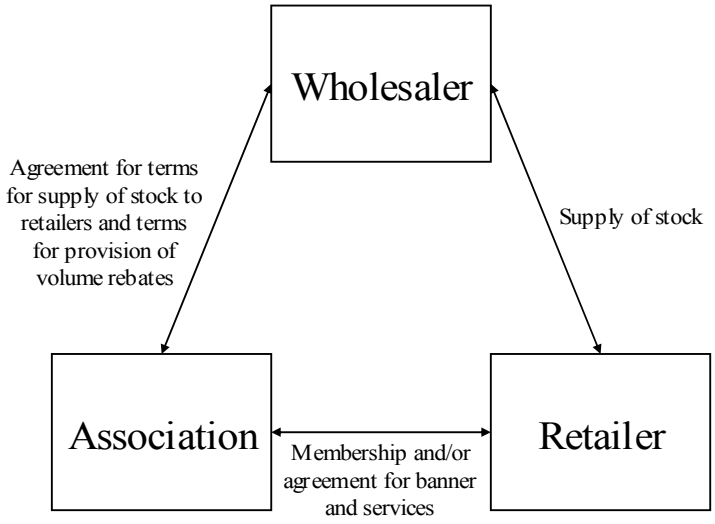
This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the ***Taxation Administration Act 1953****. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office.*

What this Ruling is about

1. The type of arrangement set out below includes the subject of Taxpayer Alert 2002/8 – Mutual associations – deductibility of contributions and derivation of income (volume allowances).

2. This Ruling examines arrangements involving three kinds of participant. There are individual retailers, who make purchases and seek the best possible terms for those purchases. There are suppliers, called wholesalers in this Ruling, from whom the retailers make purchases and who offer volume rebates or allowances in relation to qualifying purchases by retailers; those volume rebates or allowances generally are given as cash payments and are called volume rebates in this Ruling. There are bodies, called associations in this Ruling, which negotiate with the wholesalers terms on which retailers connected with an association may make purchases from the wholesalers that will qualify for volume rebates. It is by dealing in this way through the association that the best volume rebates are able to be obtained.

3. The arrangements this Ruling examines have the volume rebates for which the retailers' purchases qualify paid to the associations. Some part of the volume rebates is spent by the associations on administrative overhead, on activities benefiting individual retailers or on activities benefiting all the retailers connected with an association. A substantial balance of the rebates is then paid to the retailers, broadly according to their share of purchases from the wholesalers.



4. The participants claim that their tax treatment under the arrangement is as follows:

- On the basis that they are making contributions to their association, the retailers claim as a deduction the volume rebates that go to the association;
- The association treats the volume rebates as not income but as mutual receipts;
- The retailers treat the excess rebates returned to them as a return of mutual contributions and therefore not income; and
- The wholesalers treat the volume rebates as either deductible outgoings or as liabilities reducing the income they derive from the retailers.

5. The claimed tax treatment, if effective, would result in the retailers concerned obtaining an income tax deduction in circumstances where they bear no corresponding economic loss. From the retailers' perspective, the volume rebates go to their association; they are partly spent to their advantage and the excess is given or available to them. The retailers claim a deduction for both the gross purchase price paid to the wholesalers and the contribution to their association, while not including in income any part of the money applied for them or returned (or available for return) from the association.

6. This Ruling therefore considers the income tax consequences for the retailers and the association of this arrangement. It does not discuss the tax treatment of the wholesaler, as wholesalers have not asserted any special tax consequences for them of the arrangements compared to the usual tax consequences of giving volume rebates.

Class of persons/arrangements

7. This Ruling applies to persons who enter into or carry out the following or similar arrangements:

(i) An association negotiates with certain wholesalers terms on which retailers connected with the association may make purchases that will qualify for volume rebates. Generally the association will enable a group of retailers to operate under a common banner and/or receive shared services. These arrangements apply to those retailers connected with the association from time to time;

(ii) The association may be, but is not necessarily, incorporated;

(iii) The retailers may be, but are not necessarily, members of the association;

(iv) The retailers connected with the association make purchases from the wholesalers which qualify for volume rebates;

(v) The volume rebates go to the association;

(vi) The association meets at least some of its expenditures from the volume rebates. The association returns excess rebates to the retailers, generally but not necessarily according to their share of the purchases qualifying for volume rebates;

(vii) The association may not return all of the excess rebates to the retailers straight away. It may continue holding some in a reserve fund for future expenses, such as advertising or marketing campaigns; and

(viii) In some cases an umbrella body representing more than the retailers connected with the association may act as an intermediary between the association and the payer of the volume rebates, receiving the volume rebates from the payer and passing them on to the association.

Date of effect

8. When the final Ruling is issued, it is proposed to apply both before and after its date of issue. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Ruling

9. The ruling below is divided into three sections to deal with the three possible ways in which the arrangement can be characterised depending on the facts.

(a) Retailer entitled to volume rebate but association receives it as agent

10. The consequences set out in paragraphs 11 to 16 follow if, as set out in paragraph 32 below, the retailer is entitled to the volume rebate but the association receives it as agent for the individual retailer entitled to receive it or as a convenient agent for all of the retailers collectively.

Entitlement of retailer to volume rebate

11. The volume rebate is, under section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997), assessable income of the retailer in the income year in which it becomes due and payable (or, if the retailer is on a cash basis of accounting, when it is received).

Receipt of volume rebate by association

12. Correspondingly, the volume rebate is not included in the association's assessable income under section 6-5 of the ITAA 1997.

13. The retailer is not entitled to a deduction under section 8-1 of the ITAA 1997 for the volume rebate that goes to the association.

Expenditure incurred by association on behalf of retailers

14. A loss or outgoing would be incurred by the retailer when the association incurs expenditure on the retailer's behalf. Whether this loss or outgoing is deductible to the retailer under section 8-1 or any

other provision of the ITAA 1936 or ITAA 1997 would depend on whether the requirements of the relevant provisions are satisfied.

Return of excess rebates to a retailer

15. Excess rebates returned to the retailer by the association, or becoming available for return, are not included in the retailer's assessable income under section 6-5 of the ITAA 1997.

16. No deduction is allowable to the association under section 8-1 of the ITAA 1997 when it returns excess rebates to a retailer.

(b) Retailer entitled to volume rebate but redirects it to association

17. The consequences set out in paragraphs 18 to 22 follow if, as set out in paragraph 66 below, the retailer is entitled to the volume rebate but redirects it to the association so that the association does *not* receive it as agent for the retailers either individually or collectively. In this situation the volume rebate is called a 'redirected' volume rebate.

Entitlement of retailer to volume rebate

18. The redirected volume rebate is, under section 6-5 of the ITAA 1997, assessable income of the retailer in the income year in which it becomes due and payable (or, if the retailer is on a cash basis of accounting, when it is received).

Redirection of volume rebate to association

19. The retailer is not entitled to a deduction under section 8-1 of the ITAA 1997 for the mere redirection of the volume rebate when it goes to the association.

20. The redirected volume rebate is, under section 6-5 of the ITAA 1997, assessable income of the association in the income year in which the redirection occurs.

Return of excess rebates to a retailer

21. Excess rebates returned to the retailer by the association, or becoming available for return, are included in the retailer's assessable income under section 6-5 of the ITAA 1997.

22. No deduction is allowable to the association under section 8-1 of the ITAA 1997 when it returns excess rebates to a retailer but section 120 of the *Income Tax Assessment Act 1936* (ITAA 1936) may allow a deduction if the association is a co-operative company under section 117.

(c) Association entitled to volume rebate

23. The consequences set out in paragraphs 24 to 27 follow if, as set out in paragraph 80 below, the association rather than the retailer is entitled to the volume rebate from the wholesaler.

Entitlement of association to volume rebate

24. Section 6-5 of the ITAA 1997 applies to include in the association's assessable income the volume rebate to which it is entitled.

Payment of excess rebates to a retailer

25. If the retailer is a shareholder in the association and the payment of the excess rebates is a distribution of the association's profits, section 44 of the ITAA 1936 applies to include the amount in the retailer's assessable income on the basis that it is a dividend paid out of profits.

26. However, if this is not the case, section 6-5 of the ITAA 1997 applies to include any excess rebate paid to the retailer by the association in the retailer's assessable income when the retailer derives it. This will be when the excess rebates become due and payable (or, if the retailer is on a cash basis of accounting, when the excess rebate is received).

The association is not a co-operative company

27. The association is not a co-operative company under section 117 of the ITAA 1936.

Explanation

Possible legal characterisations of the arrangement

28. The explanation below is divided into three main sections to deal with the three possible ways in which the arrangement can be legally characterised. Those ways are that:

(a) the retailer is entitled to the volume rebates but the association receives them as agent for the individual retailer entitled to receive them or as a convenient agent for all of the retailers collectively;

(b) the retailer is entitled to the volume rebates but redirects them to the association so that the association does *not* receive them as agent in the way described in (a); or

(c) the association itself is entitled to the rebates.

29. How the arrangement is characterised will depend on the intentions of the relevant parties as reflected, among other things, in the association's constituent documents and agreements between the retailers, the association and the wholesaler.

30. It is our view that the characterisation in (a) above reflected the true legal nature of the actual arrangements of this kind. The characterisation in (b) was contended by certain parties to those arrangements, but it is not accepted in the cases examined.

31. Paragraph 7(viii) referred to the possible interposition of an umbrella body between the wholesaler and the association. This would make no difference to the characterisation or the tax consequences of the arrangements covered by this Ruling because the umbrella body, in substance, plays a similar role to the wholesaler.

Retailer entitled to volume rebate but association receives it as agent (characterisation (a))

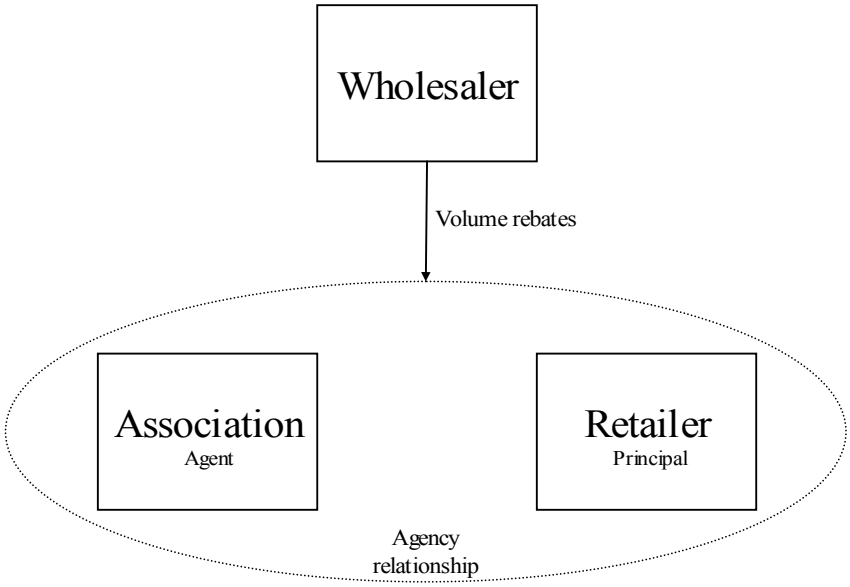
32. Under this characterisation:

(i) The association collects the volume rebates as agent for the individual retailer entitled to receive them or as a convenient agent for all of the retailers collectively;

(ii) The association then holds the rebates until required to return them to the retailer either as agent for the individual retailer or in a common fund for all the retailers jointly; and

(iii) The association uses the funds to cover expenses incurred by it on the individual retailer's behalf, for the common benefit of the retailers or to pay for services it has provided to retailers.

33. This characterisation can be diagrammatically represented as follows:



Reasons for characterisation (a)

Basis upon which the association receives volume rebates (paragraph 32(i))

34. Whether the legal nature of the arrangement falls under characterisation (a) depends on whether an agency relationship can be shown to exist in relation to the collection of the volume rebates.

35. *Butterworths Australian Legal Dictionary* (1997) defines 'agency' as follows:

> A relationship involving authority or capacity in one person (the agent) to create or affect legal relations between another person (the principal) and third parties: *International Harvester Co of Australia Pty Ltd v. Carrigan's Hazeldene Pastoral Co* (1958) 100 CLR 644; 32 ALJ 160. Whether 'agency' is constituted depends on the true nature of the agreement or the exact circumstances of the relationship between the alleged principal and agent, rather than on language adopted by the parties: *Norwich Fire Insurance Society Ltd v. Brennans (Horsham) Pty Ltd* [1981] VR 981. A relationship of agency is created either by the express or implied agreement of principal and agent, by the subsequent ratification by the principal of the agent's acts done on behalf of the principal, by operation of law, pursuant to statute, or by estoppel under the doctrine of apparent (or ostensible) authority.

36. Hence, there is an agency relationship between the association and the retailer as to the collection of volume rebates if the association is authorised by the retailer to collect the volume rebates on its behalf. This authority may be conferred expressly or impliedly. (On implied agency see definition of agency quoted above and GE Dal Pont, *Law of Agency*, Butterworths, 2001, pages 93-96.)

37. Examples of factors supporting the conclusion that there is at least an implied agency relationship between the retailer and the association in relation to the collection of volume rebates would include the following:

- The fact that relations between the retailer and the wholesaler are on terms partly or wholly arranged by the association on behalf of the retailer, particularly the creation of the retailer's entitlement to volume rebates; and
- An agreement between the association and the wholesaler stating that the association would receive the rebates 'on behalf of' the retailer. That this implies an agency agreement is supported by *Bonette v. Woolworths Ltd* (1937) 37 SR (NSW) 142 at 150 per Jordan CJ (Halse Rogers and Bavin JJ concurring):

  > Evidence that a person is purporting to do acts on behalf of a principal in some capacity in such circumstances that the knowledge and approval of the principal may fairly be inferred is evidence that the principal has authorised him to act in the particular capacity.

In the words of Jordan CJ, where such an agreement exists, the association is purporting (to the wholesaler) to do acts on behalf of the retailer in circumstances that the knowledge and approval of the principal may be inferred.

- An agreement between the retailer and the wholesaler in which the retailer acknowledges that the association has agreed to fully account for rebates and, after deducting amounts owed by the retailer to the association, to pay the entire amount to the retailer. Although such an agreement may not expressly state that the association receives the rebates on behalf of the retailer, terms to this effect are consistent with the duty imposed on agents by general law to account to their principal for money received on the principal's behalf; and

- In the case where a retailer is a member of the association, the inclusion in the association's constituent documents of one of its objects as the 'rendering of services on behalf of its members'.

38. It should be noted that this is not an exhaustive list. Hence, there may be other factors not listed here that support the conclusion that there is either an express or implied agency relationship regarding the receipt of volume rebates. Also, even though one or more of the above factors is not present does not mean that such a relationship does not exist.

39. Where the rebates are received on behalf of the retailers but the facts do not support the conclusion that the association collects the volume rebates as agent for each retailer individually, then it will follow that the association must receive them directly into a common fund for the common benefit of all the retailers as the convenient agent of all of them collectively.

Basis upon which the association holds volume rebates (paragraph32(ii))

40. In the typical type of arrangement dealt with by this Ruling, the rebates to which an individual retailer is entitled are regularly returned to that retailer after deducting expenses incurred either on that particular retailer's behalf or for the common benefit of all retailers. This supports the conclusion that the rebates are held on the individual retailer's behalf.

41. There is no inconsistency between the association holding money on behalf of an individual retailer and being authorised to spend it either for the benefit of the individual retailer or for the common benefit of all retailers.

42. Also, that each retailer's funds are not generally held in a separate account is not inconsistent with the association holding them as agent for the particular retailer. This simply means that the association's relationship in respect of those funds is debtor, not trustee. (See Dal Pont, page 320.)

43. If the facts do not support the conclusion that the association holds the funds from the rebates for each retailer individually, then they would normally support the conclusion that the association holds the funds from the receipt of the rebates in a common fund for the common benefit of all the retailers. This would usually be evident from the purpose for which the funds are held which could be inferred from the uses to which the funds are put and how the retailers benefit from the fund.

Basis upon which the association uses the funds (paragraph 32(iii))

44. That the association has authority to spend each retailer's funds either for the individual retailer's benefit or for the common benefit of all retailers is typically apparent from the formula used in the association's agreement with the retailers to calculate how much surplus each retailer is entitled to.

Taxation consequences of characterisation (a)

Assessability to retailers of volume rebates paid by wholesaler

45. Section 6-5 of the ITAA 1997 includes ordinary income in a taxpayer's assessable income when it is derived by the taxpayer. The volume rebates would be derived by the retailer in the income year in which they become due and payable or, if the retailer is on a cash basis of accounting, they would be derived by the retailer when the association receives them.

46. The retailer is taken to receive volume rebates when the association receives them as the retailer's agent by application of one of the basic tenets of agency law. As Dal Pont explains (see paragraph 19.12, page 488), a payment by a third party to an agent in satisfaction of a contractual obligation effected by that agent on behalf of a disclosed principal will be effective to discharge the third party's liability. It follows that receipt by the agent is equivalent to a receipt by the principal.

Assessability to association of volume rebates paid by wholesaler

47. Correspondingly, volume rebates paid under the arrangement are not included in the association's assessable income when they are received by the association as agent for the retailer. There is no derivation by the association at that point in time because the association only receives the rebates as agent for the association, not for its own benefit.

Deductibility to retailers of volume rebates

48. The retailers cannot claim a deduction under section 8-1 of the ITAA 1997 for the volume rebates that go to the association because there is no loss or outgoing incurred by the retailer until the association incurs expenditure on the retailer's behalf either for the retailer's own benefit, or for the common benefit of all the retailers, or charges retailers for expenses it has incurred on its own behalf by offsetting those amounts against the retailer's volume rebates. The reasons for this conclusion are set out in the following paragraphs.

49. There is little, if any, direct authority on whether or when a taxpayer can claim a deduction for moneys advanced to an agent. As a result the issue must be determined by applying general principles.

50. In *AAT Case 9897* (1994) 30 ATR 1030; (1994) 95 ATC 101 Deputy President BJ McMahon said (at paragraph 23):

> An outgoing is the opposite of income and connotes a movement of resources out of the taxpayer's control or dominion.

51. Money held by an agent on a principal's behalf is in the dominion of the principal. It follows that the principal incurs no outgoing until the agent incurs an outgoing on its behalf or the retailer is charged for expenses the association has incurred on its own behalf.

52. This is supported by Hill J's decision in *Ogilvy & Mather Pty Ltd v. FC of T* 90 ATC 4838 (*Ogilvy & Mather)*. Although Hill J gave the dissenting judgment in this case, the majority based their decision on another issue.

53. In *Ogilvy & Mather* Hill J considered whether an agent was entitled to claim a deduction for liabilities it incurred on behalf of a principal. In doing so he stated that it was the principal, not the agent, who would be entitled to a deduction if one was otherwise allowable, even if the agent agreed to accept personal liability under the contract, an obligation he likened to a guarantee. His Honour said (at 4857):

> In such a case, the principal, who is also bound to make the payment, has incurred a liability and assuming that the liability otherwise satisfies the criterion of sec. 51(1) is entitled to a deduction under that section. It would be strange if the agent, who has also incurred a liability, would be entitled simultaneously to a deduction of the same amount.

54. So, if an agent incurs a liability on a principal's behalf and that liability satisfies the other criterion in section 8-1 of the ITAA 1997 (equivalent to subsection 51(1) of the ITAA 1936), the principal, not the agent, is entitled to a deduction in respect of that liability. The corollary of this is that the principal is not entitled to a deduction before then.

55. Where the association holds the rebates in a common fund, consideration must be given to the consequences, for the issue of deductibility, of the funds being held in that way. This raises the issue of the extent to which the so called 'mutuality principle' is relevant to arrangements of the kind covered by this Ruling.

56. The Full High Court in *Sydney Water Board Employees' Credit Union Ltd v. FC of T* (1973) 129 CLR 446; 73 ATC 4129 (the *Sydney Water* case) considered the application of the mutuality principle. Barwick CJ stated:

> The description 'mutuality principle' is used, unfortunately as I think, to express the reason for the conclusion that the return to a taxpayer of a share of the surplus of a fund to which he has contributed in common with others after its use for a purpose agreed between them is not income. There is, in my opinion, no independent principle involved in reaching such a result and the description of mutuality is apt to be misleading. The creation of such a fund, its intended use and the repayment of a surplus or unused amount to the contributors will have their origin in agreements governing the amount of contribution, the purpose for which the fund may be employed, and the occasions for and the extent of any refunds. What mutuality there is, is to be found in those agreements and, in some instances, in the purpose for which the fund is to be used, i.e. for some common benefit. What distinguishes the amount refunded in such circumstances from profit or income is that the payment is made out of moneys which are in substance the money of the contributors.

57. In the same case, Mason J said that an association holding money in a common fund for the benefit of contributors to that fund is a 'convenient agent' for them as a class (see 73 ATC at 4135 and 4136).

58. It follows that, where the rebates are held by the association in a common fund for all the retailers collectively, the reasoning set out in paragraphs 49 to 54 above is equally applicable. This is so whether the rebates are received by the association as agent for each retailer individually or as the convenient agent for all of them collectively.

Assessability to retailers of excess rebates returned to them

59. Excess rebates are not included in a retailer's assessable income under section 6-5 of the ITAA 1997 at the time they are returned by the association to the retailer because they are not derived by the retailer at that time. As explained above, the rebates were derived by the retailer either when they became due and payable or when they were received by the association. From that time until when the association either incurs expenses on the retailer's behalf, charges the retailer for expenses it has incurred on its own behalf or returns the funds to the retailer, the funds do not leave the retailer's control (see paragraphs 50 to 58). Consequently, by returning excess rebates to the retailers, the association is simply returning to the retailers funds that were theirs all along.

Deductibility to association of excess rebates returned to retailers

60. It follows that no deduction is allowable to the association under section 8-1 of the ITAA 1997 upon returning excess rebates to the retailer. As the association holds the volume rebates as agent for the retailers the funds never leave the retailer's control and so cannot be a loss or outgoing of the association. As explained above, the association is simply returning to the retailer funds that were the retailer's all along.

The effect of the co-operative provisions (Division 9 of Part III of the ITAA 1936)

61. The co-operative provisions do not affect the tax treatment of the arrangement under characterisation (a) even if the retailers are shareholders in the association and the association is a co-operative company for the purposes of section 117 of the ITAA 1936.

62. If the association receives the volume rebates as agent for the retailer, then it does not receive them for the storage, marketing, packing or processing of commodities, or for the rendering of services, or in payment for commodities or animals or land sold. Rather, one of the services provided by the association to the retailers is the collection of volume rebates on their behalf. This means that at the time the rebates are received they do not constitute amounts that should be included in the association's assessable income by virtue of section 119 of the ITAA 1936.

63. The result is the same if the association receives the rebates directly into a common fund. As explained in paragraph 57 above, an association holding money in a common fund for the benefit of contributors to that fund is a 'convenient agent' for them as a class. Hence, for the same reasons as given in paragraphs 62 above, the rebates are not included in the association's assessable income by virtue of section 119 of the ITAA 1936 at the time they are received by the association.

64. As the volume rebates are not included in the association's assessable income, it follows that the association is not entitled to claim a deduction by virtue of section 120 of the ITAA 1936 for excess volume rebates it returns to its retailers because that section only applies to the assessable income of a co-operative company.

65. It is possible that the association is a co-operative company if amounts it receives for its own benefit are for the storage, marketing, packing or processing of commodities, for the rendering of services, or in payment of commodities or animals or land sold. If that is the case such amounts may be included in the association's assessable income under section 119 of the ITAA 1936 when the association offsets such amounts against funds it holds on behalf of the retailers.

Retailer entitled to volume rebate but redirects it to association (characterisation (b))

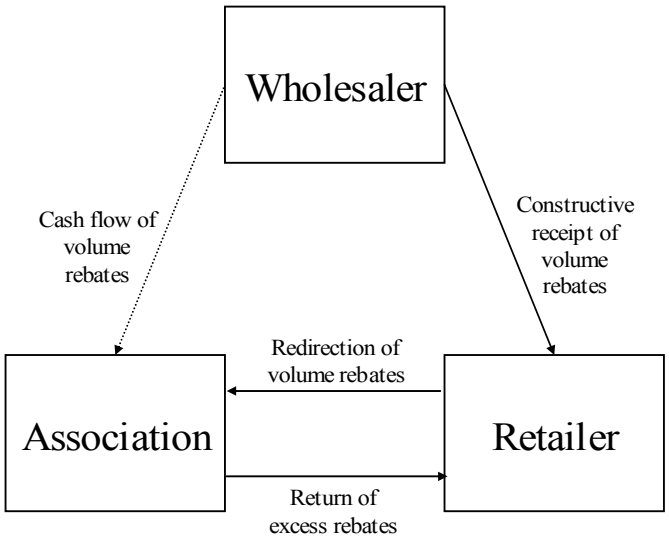
66. Under this characterisation:

(i) The rebates are constructively received by the retailer and then redirected to the association but the association does not receive the rebates as agent for the retailers either individually or collectively;

(ii) The association holds the rebates in a common fund for all the retailers jointly; and

(iii) The association uses the money held in the common fund for the common benefit of the retailers or to pay for services it has provided to retailers.

67. This characterisation can be diagrammatically represented as follows:



Taxation consequences of characterisation (b)

Assessability to retailers of volume rebates paid by wholesaler

68. The assessability to the retailers of the volume rebates paid by the wholesaler is as set out in paragraph 45. Even though the association does not receive the rebates as agent of the retailers under characterisation (b), section 6-5(4) deems the retailer to have received, and hence to have derived, the volume rebates when they are applied

or dealt with in any way on the retailer's behalf or as the retailer directs.

Deductibility to retailers of redirected volume rebates

69. The mere redirection of the volume rebates by the retailer to the association is either not a loss or outgoing incurred in the course of carrying on the retailer's business or is a loss or outgoing of capital or of a capital nature. Therefore, it would not be deductible to the retailer under section 8-1 of the ITAA 1997.

70. Both of these views are supported on the basis that the redirection is not a working expense of the retailer's business because it does not create or acquire things (e.g. goods or services) that will be consumed for the purposes of that business. Rather, it is an amount paid for the purpose of receiving a corresponding amount back at a later time (and, it would appear, in the hope of obtaining a tax deduction).

71. Although the *in toto* redirection of the volume rebates to the association is not a deduction *per se*, a deduction may be available to a retailer for some part of the redirected rebates when that part is actually outlaid. Whether this is so depends on all the facts and circumstances including what the loss or outgoing is for and the application of any relevant provision of the ITAA 1936 or the ITAA 1997. Certainly, the redirected volume rebates would not be a deductible loss or outgoing to the extent that they are returned to the retailer (for the reasons set out in paragraph 70).

72. Further, to the extent the loss or outgoing is made to build up a reserve fund for future expenses (as explained in paragraph 7(vii) above), it is a loss or outgoing of capital or of a capital nature. Building up that fund, whether it is used to build up the assets of the association, or to return excess amounts to the retailers, is of a capital character. The funds form a capital pool that provides an enduring benefit to the retailers, and contributions to it are therefore not deductible under section 8-1 of the ITAA 1997.

Assessability to association of volume rebates redirected by retailer

73. It has been claimed that the redirected volume rebates are not assessable income to the association on the basis that they are 'contributions' made by the retailers of a common fund and hence subject to the mutuality principle. However, this is not a true characterisation of the transaction because there is no correlation between the amount of the 'contributions' and the expenditure of the association.

74. In the *Sydney Water* case the question was whether the amount of interest received by the taxpayer on loans made to its borrowing members constituted income in the taxpayer's hands within the meaning of the ITAA 1936. It did. The taxpayer described the borrowing members as 'contributors', arguing that their interest payments should not be characterised as assessable income due to the application of the 'mutuality principle'. The High Court rejected the taxpayer's argument that the mutuality principle applied, holding that the interest was assessable income of the taxpayer. The fact that a borrower's interest payments were in no sense a pre-estimate of the amount required to meet his proportion of the mutual liabilities incurred on behalf of the borrowers was one of the factors taken into account by Mason J (at ATC 4136), with whom Menzies, Walsh and Stephen JJ agreed, in concluding that the circumstances did not come within the mutuality principle.

75. Similarly, in the type of arrangement dealt with in this Ruling, a retailer's redirected volume rebates are not a pre-estimate of the amount required to meet that retailer's proportion of the mutual liabilities the association incurs on behalf of all the retailers. As they are gains regularly derived by the association in the course of carrying on its business they would be included in the association's assessable income under section 6-5 of the ITAA 1997.

Assessability to retailers of excess rebates returned to them

76. Section 6-5 of the ITAA 1997 would apply to include any excess rebates returned to the retailer by the association in the retailer's assessable income as ordinary income.

77. The returns are gains regularly derived by the retailer in the course of carrying on its business (see Parson's principles of periodicity and business gains in RW Parsons, *Income Taxation in Australia*, (1985), paragraphs 2.179 and 2.83)). It is clear that obtaining the excess rebates is as much an activity of the retailer's business as obtaining the volume rebates in the first place (see *HR Sinclair & Son Pty Ltd* (1966) 114 CLR 537). This view is not based on any attempt to contend that the return of the rebates is the recoupment of a deduction; it is based on the character of the return of the excess rebates itself.

The effect of the co-operative provisions (Division 9 of Part III of the ITAA 1936)

78. The co-operative provisions may have some effect on the tax treatment of the arrangement under characterisation (b) if the retailers are shareholders in the association and the association is a co-operative company for the purposes of section 117 of the ITAA 1936.

79. To the extent the volume rebates are included in the association's assessable income, the association may be entitled to claim a deduction by virtue of section 120 of the ITAA 1936 for excess volume rebates it returns to its retailer shareholders.

Association entitled to volume rebate (characterisation (c))

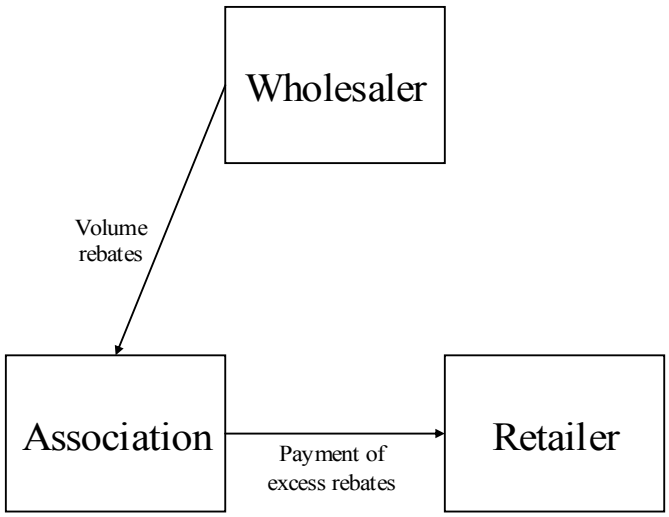
80. Under this characterisation:

(i) The association receives the volume rebates from the wholesaler in its own right, as part of its own trading income;

(ii) The association spends the funds on its own behalf and charges retailers for its services; and

(iii) Excess rebates are paid to retailers. If the retailers are members of the association, this may be as a distribution of profits.

81. This characterisation can be diagrammatically represented as follows:



Reasons for characterisation (c)

82. If the retailer is not beneficially entitled to receive volume rebates in its own right, then it is impossible for the association to either collect those rebates 'on the retailer's behalf' or for the retailer to 'direct' payment of the rebates to the association. The association must therefore receive the rebates in its own right as part of its own business profits.

Taxation consequences of characterisation (c)

Assessability to association of volume rebates paid by wholesaler

83. If the association receives the rebates in its own right as part of its own business profits then it will be included in the association's assessable income as ordinary business income under section 6-5 of the ITAA 1997.

Assessability to retailers of excess rebates paid to them

84. If the retailer is a shareholder in the association and the payment of the excess rebates is a distribution of the association's profits, section 44 of the ITAA 1936 applies to include the amount in the retailer's assessable income on the basis that it is a dividend paid out of profits. Otherwise, it would be assessable to the retailer as ordinary income for the same reasons as set out in paragraph 77.

85. If the payment of excess rebates to retailers is a dividend no deduction is allowable to the association under section 8-1 of the ITAA 1997. However, if that is not the case, a deduction would be allowable under section 8-1 of the ITAA 1997 to the association for the payment of excess rebates to retailers. This is because the payment is an outgoing incurred by the association in the course of carrying on its business for the purpose of producing assessable income, being the rebates received from the wholesaler.

The effect of the co-operative provisions (Division 9 of Part III of the ITAA 1936) on the redirected volume rebates

86. The association would not be a co-operative for the purposes of section 117 of the ITAA 1936 because one of the businesses in which it is engaged has as its primary object the making of profits from volume rebates. (See paragraph 8 of TR 1999/14: Determining the co-operative status of a company.)

The general anti-avoidance provision (Part IVA of the ITAA 1936)

87. If, contrary to this Ruling, the retailer is entitled to a deduction for the volume rebates that go to the association, the Commissioner would consider the application of Part IVA to the arrangement in appropriate cases. These cases would likely be those where the scheme gives rise to a tax benefit in the form of a tax deduction with no matching assessable income (see paragraph 5). The Commissioner would need to have regard to the factors in section 177D of the ITAA 1936 to determine if the dominant purpose of the scheme was to obtain the tax benefit.

Your comments

88. We invite you to comment on this draft Taxation Ruling. Please forward your comments to the contact officer by the due date.

Due Date: **28 January 2004**
Contact Officer: **Andrew England**
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Telephone: **(02) 6216 1599**
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Detailed contents list

89. Below is a detailed contents list for this draft Taxation Ruling:

Commissioner of Taxation
10 December 2003

Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
TR 92/20; TR 1999/14; Taxpayer Alert 2002/8

Legislative references:
- ITAA 1936 Div 9 Pt III
- ITAA 1936 44
- ITAA 1936 51(1)
- ITAA 1936 117
- ITAA 1936 119
- ITAA 1936 120
- ITAA 1936 177D
- ITAA 1997 6-5
- ITAA 1997 6-5(4)
- ITAA 1997 8-1
- TAA 1953 Part IVAAA

Other references
- Butterworths Australian Legal Dictionary (1997)
- GE Dal Pont, Law of Agency, Butterworths, 2001
- HR Sinclair & Son Pty Ltd (1966) 114 CLR 537
- RW Parsons, Income Taxation in Australia, (1985), paragraphs 2.179 and 2.83

Case references:

- AAT Case 9897 (1994) 30 ATR 1030; (1994) 95 ATC 101
- Bonette v. Woolworths Ltd (1937) 37 SR (NSW) 142
- International Harvester Co of Australia Pty Ltd v. Carrigan's Hazeldene Pastoral Co (1958) 100 CLR 644; 32 ALJ 160
- Norwich Fire Insurance Society Ltd v. Brennans (Horsham) Pty Ltd [1981] VR 981
- Ogilvy & Mather Pty Ltd v. FC of T 90 ATC 4838
- Sydney Water Board Employees' Credit Union Ltd v. FC of T (1973) 129 CLR 446; 73 ATC 4129

ATO references
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