

Societies' obligation to pay corporate tax (3/12/19)

Each corporate trader is liable to pay corporate income tax (CIT), except for cases prescribed by the CIT Act, but societies are covered by exceptions. In statutory cases, the State Revenue Service (SRS) may examine a society's economic activity, find it unlawful, and charge CIT.

The basis for a tax exemption

To make sense of SRS actions, we should remember why societies ever enjoy a special tax treatment for economic activity (trade or business).

A society is a voluntary association of persons set up to achieve the purpose stated by its articles of association that is anything other than making a profit. So a society is essentially a not-for-profit organisation that is permitted to carry on a trade or business as an additional activity that involves maintaining or using its property as well as any other trade or business for achieving its aims. A CIT exemption for economic activity is given to societies for the following reasons:

1. Their main purpose is anything other than making a profit;
2. The lawmaker has recognised the establishment of societies as a significant step that helps strengthen a democratic and civic community and deserves support from the government.

Criteria for economic activity

The CIT Act and the Societies and Foundations Act lay down the following conditions for a society's economic activity:

1. Making a profit or capital gain must not be the society's main purpose, and its trade or business may be conducted as an additional activity only;
2. Any income gained must be used only for achieving the purpose stated in its articles of association;
3. Any profit must not be shared among its members.

It should be primarily assessed whether a society carries on the core activity stated by its articles of association or exists as a shell. Any trade or business the society conducts cannot become its core activity. This is a basis for finding that the actual and sole purpose of the society's existence is making a profit from its income rather than achieving its stated aims. The Supreme Court finds that assessing a society's trade or business is inextricably linked with assessing its core activity as a not-for-profit organisation. Dealing with profits is also a key stage of review. If any profit has been used unlawfully, i.e. it has not been used for achieving the society's purpose, a tax exemption is no longer available. Otherwise there would be a basis for finding that the society has been used for obtaining unlawful tax advantages in a commercial environment.

Case law

Having assessed a society's lending transactions in a certain case, the SRS found the society had carried on a trade or business to make a profit and was not, therefore, eligible for a CIT exemption. In this case, lending was found to be the only activity the society actually pursued. Refuting the argument that the society's proposed activity requires considerable investment and so the society first needs to gain additional income, the Supreme Court recognised this interpretation as unlawful because it is inconsistent

with the meaning and substance of the concept of society and contrary to the reasons why the lawmaker has exempted societies from CIT. This approach also makes it impossible to administer taxes in societies because any person registered as a society could carry on a trade or business, make a profit, and avoid paying CIT on the pretext that sometime in the future it will carry on a not-for-profit activity geared towards achieving its aims.

The conclusion

A society found to be conducting a trade or business for the purpose of making a profit or capital gain is ineligible for a CIT exemption.