THE DEFINITION OF GAIN FOR THE PURPOSES OF INCORPORATION

Introduction

1. The purpose of this paper is to examine the meaning of "gain" in the context of the Companies Act 1955 and the Incorporated Societies Act 1908. The former statute prohibits unregistered companies, associations and partnerships of more than twenty-five persons formed "for the purpose of carrying on any business that has for its object the acquisition of gain",[1] while the latter provides for the incorporation of societies, of not less than fifteen persons, which are not established for the purpose of "pecuniary gain".[2]

In both cases the presence or absence of gain has a decisive effect on the legal status of an association or society. On the one hand, an association not formed for gain has the choice of remaining unincorporated or registering under the Incorporated Societies Act. On the other hand, an association formed for gain may not register under that Act and, if it consists of more than twenty-five persons, it may be illegal unless registered under some other statute.[3]

This paper will consider, first the background to these associations in the common law and the history of the two statutes, secondly the meaning given by the courts to the main terms in the relevant sections, and thirdly the approaches of the courts in ascertaining whether or not an association is formed for gain. The third area raises the questions of whether gain must be the main object of the association and whether gain is to be ascertained from the form or the substance of the association.

2. The underlying problem is the determination of the dividing line between associations formed for gain and those formed for some other purpose. Although the advantages of incorporation have meant that most commercial enterprises will now voluntarily register under the Companies legislation, it may still be an open question whether groups such as mutual re-insurance schemes, informal trade protection associations and investment clubs which prefer to remain unincorporated, will be caught by the prohibition in the Companies Act. Furthermore, this problem is of particular relevance in relation to the Incorporated Societies Act because it is not unusual for *prima facie* non-profit associations to engage in subsidiary commercial activities. For instance, what would have been the attitude of a New Zealand court[4] to the American cases involving the University of Georgia Athletic Association which ran a

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1. Section 456 (1). The 1966 amendment to this section is referred to in n 23.
2. Section 4 (1).
3. The other statutes are referred to in para. 11.
4. Under the Incorporated Societies Act 1908, s. 12. there is a right of appeal to the Supreme Court from any refusal of the Registrar of Incorporated Societies to register a society.

laundry business on campus[5] and the Chevrolet Dealers in Pittsburgh who met to discuss trade problems, including the problem of increasing their business?[6]

3. The nature of the topic is also usefully illustrated by the one case in which both statutes were together in issue. This was *In re Proprietary Articles Trade Association of South Australia Inc.*[7] which involved an incorporated voluntary trade protection association of manufacturers, wholesalers and retailers who maintained the prices of goods listed by the manufacturer-members. The association had power to place its members on a "stop list" and to fine members for underselling or overcharging, but it neither traded nor made any profit itself.

After several years as an incorporated association,[8] its registration was cancelled and it was declared illegal under the Companies Act.[9] The association applied to the court to have its registration restored and Abbott J., after considering its activities and objects, concluded that it was entitled to be registered on the ground that it did not secure profits directly to its members.[10] This reasoning compelled him to make a similar decision on the question of illegality under the Companies Act. He held that the association was not carrying on any business and, even if it had been, the acquisition of gain was not one of its objects.

I. BACKGROUND

Common Law

4. Voluntary groups or associations of persons are not recognised by the common law as entities separate from their members. As a result an association is generally unable to perform legal acts or enter into legal transactions in its own name, and its members may be personally liable for the debts of the association.[11] Originally the purpose for which the association was formed had no effect on its position at common law, but this changed during the nineteenth century.[12]

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5. *Westbrook* v.*University of Georgia Athletic Association Inc.* 206 Ga. 667; 58 S.E. 2d 428. See infra para. 31.
6. *Application of Pittsburgh Chevrolet Dealers' Association* 296 Pa. 431; 146 Atl. 26 (1929). See infra n. 126.
7. [1949] S.A.S.R. 88.
8. Under the South Australian Associations Incorporation Act 1929-1935 (now 1956-1965), s. 3 excluded associations formed "for the purpose of trading or securing pecuniary profit". The difference between the wording in this section and s. 4 of the Incorporated Societies Act 1908 is referred to in para. 32.
9. S. 9 (2) of the South Australian Companies Act 1934-1939 which is the equivalent of s. 456 (1) of the New Zealand Act.
10. This conclusion is referred to in more detail in paras. 22 and 35.
11. The application of the laws of contract and trust to unincorporated associations are beyond the scope of this paper: see Lloyd, *The Law of Unincorporated Associations.*
12. This change culminated in the decision in *Wise* v. *Perpetual Trustee Co. Ltd.* [1903] A.C. 139 (P.C.) See also Ford, *Unincorporated Non-Profit Associations* at 51 and Josling and Alexander *The Law of Clubs* (2nd ed. 1969) at p. 5.

Unincorporated groups may now be divided into two broad categories, viz. partnerships and non-trading associations. The basis for this broad division is the presence or absence of gain as an object of the group because a partnership exists when two or more persons carry on a business with a view to making profit,[13] while a non-trading association by definition is not formed for profit.[14] One of the main consequences of this division was that the courts were able to introduce a form of limited liability for the members of non-trading associations, particularly in the case of social clubs.[15]

Although this consequence of the division may mean that it is necessary to know whether or not an unincorporated association is formed for gain, it appears that this point has not come directly before the courts. One case which might have been on the border line was the decision in *Caldicott* v. *Griffiths*[16] that a trade protection association was not a partnership on the ground that the members merely subscribed to a fund for the purpose of obtaining information useful in their business.

The influence of this broad division at common law was quite apparent when the legislature intervened to grant corporate status to certain groups.

Companies Legislation

5. The idea of distinguishing between commercial and non-commercial enterprises on a legislative basis was first seen in the Joint Stock Companies Act 1844[17] which enabled any partnership of over twenty-five members to register as long as it was established for a commercial purpose or for profit. The Act was a permissive instrument, granting the benefits of incorporation, but not limited liability, to those companies which fulfilled its requirements.

In 1855 an Act[18] was passed granting limited liability to joint stock companies, but the major change for the purposes of this article occurred in the following year with the enactment of the Joint Stock Companies Act 1856.[19] For the first time incorporation was not a permitted status but compulsory in the case of any partnership of more than twenty persons who carried on any trade or business which had gain as its object.[20] A very similar provision was enacted in New Zealand as section 4 of the Joint Stock Companies Act 1860. The general purpose

13. See *Lindley on Partnership* (12th Ed. 1962, ed Scamell) at 11, and now the Partnership Act 1908, s. 4 (1).
14. The relationship between the words "profit" and "gain" is referred to in para. 16.
15. E.g. *Flemyng* v. *Hector* (1836) 2 M. & W. 172; 150 E.R. 716. See also supra n. 13.
16. (1853) 8 Ex. 898; 155 E.R. 1618. See infra para 35.
17. 7 & 8 Vict. c. 110.
18. 18 and 19 Vict. c. 133.
19. 19 & 20 Vict. c. 110.
20. Section 4.

of these provisions was to protect both creditors and investors from the difficulties of dealing with large business associations whose numerous members were not easily identifiable.[21]

In 1862 the joint stock companies legislation was replaced by the first United Kingdom Companies Act[22] on which the New Zealand Companies Act of 1882 was modelled. These Acts altered section 4 so that the main part of it read:

> . . . no Company, Association, or Partnership consisting of more than Twenty Persons shall be formed, after the Commencement of this Act, for the Purpose of carrying on any other Business that has for its Object the Acquisition of Gain by the Company, Association, or Partnership, or by the individual Members thereof, unless it is registered . . .

Since 1862 there have only been minor amendments to what is now section 434 of the United Kingdom's Companies Act 1948 and section 456 (1) of the New Zealand Companies Act 1955. The most recent amendments have enabled certain professional partnerships to be exempted from the prohibition.[23]

Incorporated Societies Legislation

6. Both the South Australian and New Zealand Legislatures went a step further than the United Kingdom when they enacted separate statutes in the 1890's[24] respectively which enabled associations not formed for pecuniary gain to become incorporated. This step has also been taken in several American jurisdictions,[25] but in England such associations are still governed by the common law relating to unincorporated clubs, unles they have registered under the Companies Act.[26]

In New Zealand such extensive use was made of this new method of incorporation[27] that, despite amendment in 1906, it was found necessary to pass a new Act in 1908. The scheme of this Act, which is the current Incorporated Societies Act, makes it quite clear that the absence of gain is the major characteristic of an incorporated society. The preamble of the Act states that its purpose is:

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21. See Calvert, "The Prohibition of Large Associations", (1962) 26 Conv. (N.S.) 253.
22. 25 & 26 Vict. c. 89.
23. Companies Act 1967, s. 120 (U.K.), and Companies Amendment Act 1966, s. 12 (N.Z.).
24. Associations Incorporation Act 1890 (South Australia), Unclassified Societies Registration Act 1895 (Western Australia) and Unclassified Societies Registration Act 1895 (N.Z.).
25. See Oleck, *Non-Profit Corporations, Organisations and Associations* (2nd. ed. 1965) and "Nonprofit Corporations—Definition" (1963) 17 Vanderbilt L. R. 336. The Canadian State of British Columbia has also taken the step: see the Societies Act. B.C. Rev. Stat. c. 362 (1960).
26. Companies Act 1948, ss. 1 & 19. The same opportunity exists in New Zealand: see Companies Act 1955, ss. 13 & 33.
27. See (1908) 143 New Zealand Parliamentary Debates 155 (House of Representatives) and 441 (Legislative Council).

> . . . to make provision for the incorporation of societies which are not established for the purpose of pecuniary gain.

Section 4 provides that only societies with fifteen or more members who are associated for a lawful purpose "but not for pecuniary gain" may become incorporated and section 5 sets out a number of circumstances when persons shall not be deemed to be associated for pecuniary gain.[28] Finally it is an offence for a society once it is incorporated to engage in operations involving pecuniary gain: section 20.

II. GAIN

Who acquires the gain?

10. Before examining the meaning of the word gain itself, it is necessary to consider the nature of the group which may or may not have been formed to acquire gain. Section 456 of the Companies Act is only concerned with those groups of people who comprise companies, associations or partnerships, while section 4 of the Incorporated Societies Act is concerned with those who comprise societies.

11. Section 456, however, does not apply to associations "formed in pursuance of some other Act of the General Assembly". Associations which are exempted from prohibition under this provision include those registered under the Friendly Societies Act 1909[29] or incorporated under the Building Societies Act 1965 as well as persons registered under the Moneylenders Act 1908[30] and trade unions incorporated under the Industrial Conciliation and Arbitration Act 1954. The difference between registration and incorporation in relation to the word "formed" may be important because it was considered in *Marrs* v. *Thompson*[31] that an unregistered friendly society was "formed" under the Friendly Societies Act, whereas in *In re Ilfracombe Permanent Mutual Benefit Building Society*[32] an unincorporated building society was held not to be "formed."

12. Although "company" is defined in section 2(1) of the Companies Act 1955 as meaning a company registered under the Act, this definition does not apply if the context, as in section 456, requires otherwise. The word in this section which must refer to an unincorporated association has been described as follows:

> The word "company" has no strictly technical meaning. It involves, I think, two ideas—namely, first, that the association is of persons so numerous as not to be aptly described as a

28. See para. 33 post.
29. E.g. *Peat* v. *Fowler* (1886) 55 L.J.Q.B. 271.
30. This example was suggested in *Wilkinson* v. *Levison* (1925) 42 T.L.R. 97.
31. (1902) 86 L.T. 759.
32. [1901] 1 Ch. 102.

> firm; and secondly, that the consent of all the other members is not required to the transfer of a member's interest.[33]

"Partnership" also has a generally accepted meaning, viz. the relationship which exists between persons carrying on a business in common with a view to profit. The statutory definition of "partnership" followed the common law meaning[34] so that problems have not arisen in construing this word in section 456. For instance, an avowed farming partnership[35] and a property syndicate[36] were held to be clearly within the section.

13. Some difficulties have arisen, however, in construing the wider term "association". It might be viewed as a net to catch all those groups, not quite companies or partnerships, which are carrying on business for gain. On the other hand, it might be considered superfluous when it is read between the other two terms. The English Court of Appeal in *Smith* v. *Anderson*[37] held that an investment trust was not an association on the ground *inter alia* that neither the trustees nor the certificate holders in the trust formed an association. In reaching this conclusion each judge expressed doubt about the necessity for the word "association" in the section but adopted different approaches. While James L.J. took the terms "company" and "association" to be synonymous,[38] Brett L.J. confessed:

> I have some difficulty in seeing how there could be an association for the purpose of carrying on a business which would be neither a company nor a partnership . . .[39]

The third alternative was taken by Cotton L.J. when he said that "association"

> . . . must denote something where the associates are in the nature of partners . . .[40]

Although Brett L.J. was prepared to concede that an association might be created which was not strictly a company or a partnership, the majority did not mention this possibility.

In a number of subsequent decisions the point was not raised and the judgments simply refer to the groups involved as associations or use "association" interchangeably with "company". Decisions of this

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33. *Re Stanley; Tennant* v. *Stanley* [1906] 1 Ch. 131, per Buckley J. at 134. See also *Smith* v. *Anderson* (1880) 15 Ch.D. 247, per James L.J. at 273, and *Nathan* v. *Federal Commissioner of Taxation* (1918) 25 C.L.R. 183 at 192-3.
34. Supra n. 14.
35. *Harris* v. *Amery* (1865) L.R. 1 C.P. 148.
36. *Herbert* v. *Greathead* [1936] N.Z.L.R. 185.
37. (1880) 15 Ch.D. 247.
38. Ibid., at 273.
39. Ibid., at 277.
40. Ibid at 282.

nature have involved a mutual marine insurance association,[41] a mutual benefit society,[42] a superannuation fund,[43] a co-operative sheep dip[44] and a trade protection association.[45]

The indefinite result of *Smith* v. *Anderson*[46] on this point enabled a Victorian judge in *Ballantyne* v. *Raphael*[47] to suggest a subjective approach when he held that the persons who joined a property syndicate did not intend to carry out their scheme in any way contrary to the law. The confusion was not ended by the Full Court of Tasmania in *In re the Tasmanian Forests & Milling Co. Pty Ltd*[48] which, after referring at some length to *Smith* v. *Anderson*[49] concluded that an "association" must be:

> . . . so much in the nature of a partnership that if it had been formed to carry on business with a view to profit it would have been a partnership.[50]

On the facts of that case it was held that an association in the nature of a partnership did exist between an incorporated company and the members of the public to whom it sold "timber certificates" which entitled the holders to a proportion of the company's proceeds as well as a representative on the board of directors.

Finally, there is the approach of Mayo J. in *In re Commonwealth Homes and Investment Co. Ltd*[51] where he considered that, to establish an association, a legal relation must be created between the members giving rise to joint rights or obligations or mutual rights or duties. On the facts of that case he held *inter alia* that the holders of certain bonds for the purposes of obtaining loans and acquiring house property did not form an association because the bond contracts did not create any rights or duties, either *inter se* or against any fund or property. This broad approach which gives a general meaning to "association" may be preferred, but a conclusive decision has yet to be given.

14. It should also be noted that under section 456 the gain may be acquired by the "individual members" of the company, association, or partnership. The importance of this is illustrated by the decision in *In*

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41. *In re Padstow Total Loss and Collision Assurance Association* (1882) 20 Ch.D. 137 (C.A.) *Lindley,* supra n. 14 at 14, notes that these cases have involved associations which do not constitute partnerships.
42. *Jennings* v. *Hammond* (1882) 9 Q.B.D. 225.
43. *Armour v. Liverpool Corporation* [1939] 1 Ch. 422.
44. *In re Riverton Sheep Dip* [1943] S.A.S.R. 344.
45. *In re Proprietary Articles Trade Association of South Australia Inc.,* supra n. 7.
46. Supra n. 37.
47. (1889) 15 V.L.R. 538 at 556.
48. (1932) 27 Tas. L.R. 15.
49. Supra n. 55.
50. Supra n. 66 at 27.
51. [1943] S.A.S.R. 211. See also *Re Caledonian Society* 1928 S.C. 633.

re Padstow Total Loss and Collision Assurance Association[52] where it was held that, although there was no gain by the association it was still illegal because there was gain by the individual members. It has also been held that there need not be gain by *all* the individual members.[53]

15. Under the Incorporated Societies Act it is the "society" which must not be formed for "pecuniary gain". The context requires that the term "society" must be given effect so that the definition of "society" in section 3 as "a society incorporated under this Act" does not apply. The courts have not had occasion to interpret the term, but it will presumably have a broad meaning encompassing any group of people with a common object. Both section 4 of the Incorporated Societies Act and section 456 of the Companies Act refer to an express number of "persons" comprising the group. The word "person" raises a number of problems which have not yet reached the courts and which are outside the scope of this paper.[54]

The approaches to defining "gain"

16. As with many words in statutes, there are both broad and narrow approaches to defining "gain". The broad or general meaning is the acquisition or increase of advantages, possessions or resources consequent upon some action or event. The narrow or particular meaning limits the subject-matter to financial gain, or more accurately in accounting terms to profits. This is shown by the classic definition of "profits" which was given by Fletcher Moulton L.J. in *In re Spanish Prospecting Co. Ltd.*[55] when he said:

> "Profits" implies a comparison between the state of a business at two specific dates usually separated by an interval of a year. The fundamental meaning is the amount of gain made by the business during the year.[56]

An example of a statute where the narrow approach has been adopted in relation to the word "gain" is the Land and Income Tax Act 1954. The term "assessable income" is deemed to include all "profits or gains" derived from any business and the courts have drawn no distinction between the two words.[57] It is clear, however, that the word "gain" in a

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52. Supra n. 41. See also *Re Southside Plaza Merchants' Association* [1965] N.S.W.R. 1454.
53. *Shaw* v. *Benson* (1883) 11 Q.B.D. 563 (C.A.) per Brett M.R. at 570-1.
54. The problem relates to the definition of "person" in the the Acts Interpretation Act 1924, s. 4, as including bodies corporate and unincorporate. The point was noted in *In re the Tasmanian Forests & Milling Co Pty Ltd.*, supra n. 48, at 27. See also the Incorporated Societies Act, 1908, s. 29, which enables corporate bodies to become members of incorporated societies.
55. [1911] 1 Ch. 92. The case involved the interpretation of the word "profits" in a contract of service with a company.
56. Ibid at 98.
57. S. 88 and see Cunningham & Thompson, *Taxation Laws of New Zealand* (6th ed. 1967) Vol. 3, para. 3008. Also "profits" in a taxation sense require a consideration of numerous special sections relating to assessable income and deductions.

statute may be open to both the broad and narrow approaches. This is indicated by a case decided under the Law Reform Act 1936, where "gain" was included in section 7 which related to the amount of damages which the court might award to the dependants of a deceased person. The court was prohibited from taking into account "any gain" that was consequent on the death of a deceased person. In *Alley* v. *Alfred Buckland & Sons Ltd.*[58] Ostler J. said:

> The words are so wide and so clear that I find it impossible to hold that they can have any other than their literal meaning. "Any gain" must mean "and gain whatsoever" . . .[59]

And later:

> The section is speaking of damages and must therefore refer to financial gain. The words "any gain" mean no more than "any increase in financial resources".[60]

Despite apparently supporting both approaches he concluded that, in assessing the damages, no "profit" to a dependant consequent on death could be taken into account.

17. The questions which arise, therefore, are whether the broad or narrow approach has been adopted in construing "gain" in the Companies Act and "pecuniary gain" in the Incorporated Societies Act, and whether there is any significance in the approach adopted. The point was first considered in relation to the Companies Act in *In re Arthur Average Association for British, Foreign, and Colonial Ships, Ex parte Hargrove & Co.*[61] This case involved an unregistered mutual marine insurance association in which the members agreed to insure each other's ships by paying premiums which formed a fund out of which any losses suffered by the members were paid. If the fund was insufficient the members were to contribute towards the deficiency on a *pro rata* basis. In the opinion of Jessel M.R. the reserve fund, which would result if the premiums were sufficient to cover the losses, showed that the association was formed for the purpose of "profit" and he also noted that the individual members received a "gain" if they lost a ship.[62] As a result it was held that the association was illegal and a creditor company could not recover its debt from the association under a void policy. Although the Court of Appeal upheld this decision on a different ground, the discussion of the meaning of "gain" in the judgment of Jessel M.R. has been accepted as the classic definition:

> Now, if you come to the meaning of the word "gain", it means acquisition. It has no other meaning that I am aware of. Gain

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58. [1941] N.Z.L.R. 575. The relevant part of s. 7 of the Law Reform Act 1936 is now part of s. 7 of the Death by Accidents Compensation Act 1952.
59. Ibid., 582.
60. Ibid., 584.
61. (1875) 10 Ch. App. 542.
62. The question of whether a loss may amount to a gain is considered infra at para. 19.

> is something obtained or acquired. It is not limited to pecuniary gain. We should have to add the word "pecuniary" so to limit it. And still less is it limited to commercial profits. The word used, it must be observed, is not "gains" but "gain", in the singular. Commercial profits, no doubt, are gain, but I cannot find anything limiting gain simply to a commercial profit.[63]

This interpretation accepts that the narrow definition is included in the meaning of "gain" in section 456 of the Companies Act, but recognises that it is not limited to that meaning. This result is to be contrasted with the Incorporated Societies Act 1908[64] where the word "pecuniary" has been added to "gain" so that the meaning there has been limited to the acquisition of financial advantages or resources, but not to "profits" in the strict accounting sense.

18. If the broad formulation of the meaning of "gain" as proposed by Jessel M.R. was taken literally, then most associations would be caught by section 456 because even charities and sporting clubs are formed to obtain or acquire "something". It is submitted, however, that the definition must be read in the light of the the object of the Act and the context of the section. Later in the case Jessel M.R. observed:

> It seems to me that the Act broadly means this: all commercial undertakings shall be registered. It distinguishes in so many words—it intends to distinguish—between commercial undertakings on the one hand . . . and what we may call literary or charitable associations on the other hand, in which persons associate, not with a view of obtaining a personal advantage, but for the purpose of promoting literature, science, art, charity, or something of that kind.[65]

This broad distinction between commercial and non-commercial associations is fundamental. Section 456 makes this clear because associations are prohibited from acquiring gain by carrying on a "business".[66]

As with the mutual marine insurance association in *In re Arthur Average*[67] itself, the general definition is therefore restricted in application to the extent that the section is only concerned with commercial enterprises. Further, as it is difficult to envisage a commercial enterprise which would be formed for non-commercial gain it might be thought that there is no important difference between the two approaches to the

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63. Supra n. 61 at 546-7. This passage was expressly accepted in *In re Riverton Sheep Dip* [1943] S.A.S.R. 344, per Mayo J. at 348, and in *In re Proprietary Articles Trade Association of South Australia Inc.*, supra n. 7, per Abbott J. at 95, and it was accepted by implication in *Greenberg* v. *Cooperstein* [1926] 1 Ch. 657, per Tomlin J. at 663.
64. Section 4. See also s. 5 which is considered infra at para. 33.
65. Supra n. 61 at 548.
66. See infra para. 24.
67. Supra n. 61.

definition of gain, but the real significance is seen in relation to the narrow construction of the word "profit" which would enable any association showing a loss in its accounts to claim automatically that it was not formed for gain.

Is a loss a gain?

19. At first sight the question whether a loss may be a gain appears to be nonsensical because "loss" is the antonym of "gain". Yet this truism overlooks the vital distinction between an accounting "profit" or "loss" and a legal "gain". The latter is not based on an accounting exercise, but on an examination of the "object" of the particular association. Section 456 of the Companies Act expressly covers any association "that has for its object the acquisition of gain" while section 4 of the Incorporated Societies Act includes any society of persons associated "not for pecuniary gain". It is suggested that this difference in wording does not affect the main task under both Acts of ascertaining the object of an association.

20. The question, therefore, becomes whether an association, which incurs an accounting loss either for itself or its members, may still have "gain" as its object. The leading case on this question is the English Court of Appeal decision of *In re Padstow Total Loss and Collision Assurance Association.*[68] In that case an unregistered mutual marine insurance association enabled those who effected policies with it to become members and to insure their ships for a maximum of three quarters of their value. In the event of a total loss of a ship, the members of the association paid the loser the amount for which he had insured it rateably, according to the amounts assured to them respectively. In an application for leave to appeal against an order winding-up the association, the court held *inter alia* that the association was within the section and, therefore, had no legal existence so that the winding-up order must be discharged.

Each member of the court considered that there was a gain even although any member of the association who lost a ship would not recover the total loss. Jessel M.R. stated the position thus:

> Is it the less an acquisition of gain because the event which makes it payable happens to be a loss? It does not appear to me that the word "gain" can have any such limitation put upon it. According to the strict meaning of the word there is a gain when the insured receives a large sum in consideration of his having paid a small one . . .[69]

Although Jessel M.R. relied on the strict meaning to decide that there was a gain, he was referring to an accounting exercise carried out between the member and the association and not to the position of the

68. (1882) 20 Ch.D. 137 (C.A.)
69. Ibid., 145.

member who, in accounting terms, still suffered a loss. This latter point was recognised by the other two judges. Brett L.J. said:

> The question, therefore, is reduced to this, whether it can be properly said that the business was being carried on by them for the purpose of gain. An individual member loses his ship, and he gets from his brother associates a sum of money, which partially indemnifies him for the loss. Given the loss of the ship, what he gets from them seems to me to be clearly a gain to him.[70]

Lindley L.J. agreed that a "diminution of loss" was a gain within the meaning of the section.[71]

This case was followed by implication in *Greenberg* v. *Cooperstein*[72] where a club with branches which made loans on interest to its members and distributed any surplus amongst them at the end of fixed accounting periods, was held to be an illegal association. In reaching this conclusion Tomlin J. said:

> It has, I think, been laid down that the "acquisition of gain" does not necessarily mean the acquisition of commercial profit. It is sufficient that the association carries on a business for the purpose of obtaining payments, and it is not necessary that the business should result in a commercial profit at the end of the accounting period.[73]

21. These two decisions clearly establish the principle that an accounting loss does not prevent an association from having gain as its object in law. In fact the principle has been applied in the United Kingdom to decide that a polio victim whose annual earnings did not cover his expenses and unpaid articled clerks were "gainfully occupied" for the purposes of the national insurance legislation.[74] It is also interesting to note that the same principle evolved quite independently in a number of early New Zealand rating cases.[75]

22. The only decision which has suggested that a loss might mean that an association did not have gain as its object is the *Proprietary Articles Trade Association* case.[76] In that case, it will be remembered, Abbott J. had to decide whether a trade protection association was properly registered as an incorporated society and whether it was an illegal

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70. Ibid., 148.
71. Ibid., 149.
72. [1926] 1 Ch. 657, and see casenote in (1928) 22 L.T. 166.
73. Ibid., 663.
74. *Vandyk* v. *Minister of Pensions and National Insurance* [1955] 1 Q.B. 29 (polio victim): *Benjamin* v. *Minister of Pensions and National Insurance* [1960] 2 Q.B. 519 (articled clerk) and *In re J. B. Griffiths, Quinn & Co.* (1968) 5 K.I.R. 128 (articled clerks).
75. See n. 80 post.
76. Supra n. 7.

association under the Companies Act. In relation to the second question Abbott J. reasoned:

> The only contention by the Registrar is that as a result of price fixing there is or might be some 'gain" (in its widest sense) to the individual members. I do not at all agree with this contention; I think it might with equal force be said that there is or might be considerable loss to individual members.[77]

To the extent that this passage infers an inroad into the principle that a loss may amount to a gain, it is suggested it is too wide. In fact, however, Abbott J. went on to say that even assuming there was a gain in the case before him, then it was not one of the objects of the Association to make such gains.

23. As far as incorporation as a non-profit association is concerned, both the Australian Associations Incorporation Acts and the New Zealand Incorporated Societies Act have adopted the narrow definition in using the words "pecuniary profit" and "pecuniary gain" respectively. While these terms clearly exclude associations formed for acquiring commercial profits, it is suggested that on the basis of the principle of *In re Padstow*[78] they would also exclude associations which incurred accounting losses but which ultimately intended to acquire profits. Examples of associations which might be in this category would be the educational institutions dealt with in a number of New Zealand cases decided under the rating legislation before 1968.[79]

The purpose of this legislation was to except from the definition of rateable property lands occupied by certain religious buildings and schools provided they were not owned or occupied for "pecuniary gain or profit". In several cases it was considered that certain private schools which operated at a loss were within the proviso for the reason that their object was gain.[80] Thus, although these institutions were established for a recognised charitable purpose, namely the advancement of education,[81] they would not have been entitled to registration under the Incorporated Societies Act.[82]

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77. Ibid., 96.
78. Supra n. 68.
79. Rating Act 1925, s. 2. This Act has been repealed by the Rating Act 1967 which came into force on 1st April 1968. See now s. 146 which contains the words "private pecuniary profit".
80. *Mayor, Councillors, and Citizens of the City of Christchurch* v. *Ridddell* (1914) 34 N.Z.L.R. 226 (Anglican girls school); *Hawke's Bay County* v. *Welch* [1919] N.Z.L.R. 474 (school for Maori boys run by Church of Latter Day Saints); *One Tree Hill Road Board* v. *Auckland Presbyterian College for Ladies Ltd.* [1927] N.Z.L.R. 559 (Defendant school owned by a limited company; and *Auckland City Corporation* v. *King's School Auckland* [1938] N.Z.L.R. 157. cf. *Christchurch City Corporation* v. *Christ's College* [1920] N.Z.L.R. 662 (C.A.)
81. *Commissioners for Special Purposes of Income Tax* v. *Pemsel* [1891] A.C. 531 (H.L.). See per Lord Macnaghten at 583.
82. This assumes the schools were owned by 15 or more persons. In the unlikely event that the schools were owned by more than 25 persons then s. 456 might apply.

"Carrying on any business"

24. It has already been noted that the general definition of gain is restricted in its application to the Companies Act because an association must be "carrying on" a "business" to be caught by section 456. This requirement distinguishes the provision from section 4 of the Incorporated Societies Act which applies equally to non-commercial enterprises formed for pecuniary gain.

25. It is well established that the expression "carrying on" implies a repetition of acts, so that an association formed for doing one particular act which is never to be repeated is excluded.[83] Generally the courts have not been faced with any problem in construing the term "business" because in most of the cases under section 456 it has been clear whether or not the particular association was carrying on a business.[84] It is possible to conclude that apart from a few exceptions[85] and an early conflict as to the place of "business" in section 456, the courts have tended to construe the term widely to mean practically any activity which is an occupation as distinct from a pleasure.[86]

26. The early conflict arose because Jessel M.R. considered that the word "business" added nothing to the section on the ground that a company, association or partnership would only acquire gain through a business.[87] This view was rejected by the Court of Appeal in *Smith* v. *Anderson*[88] and Brett L.J. said:

> The statute meant to deal, not with people who were associated for the purpose of obtaining gain, but with people who were associated together for the purpose of carrying on a business having for its object the acquisition of gain.[89]

The effect of this change in approach was that the persons who subscribed to the fund which was to be invested in company shares by

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83. *Smith* v. *Anderson*, supra n. 37, per Brett L.J. at 277-8, and *Herbert* v. *Greathead* [1936] N.Z.L.R. 185, per Smith J. at 188.
84. Farming (*Harris* v. *Amery* (1865) L.R. C.P. 148), mutual insurance (*In re Padstow Total Loss and Collision Assurance Association,* supra n. 68, and see also *Cornish Mutual Assurance Co. Ltd.* v. *Commissioners of Inland Revenue* [1926] A.C. 281 (H.L.)), money-lending (e.g. *Jennings* v. *Hammond* (1882) 9. Q.B D. 225, and *Greenberg* v. *Cooperstein,* supra n. 72), purchasing property (*Herbert* v. *Greathead* [1936] N.Z.L.R. 185), and operating a sheep dip (*In re Riverton Sheep Dip* [1943] S.A.S.R. 344) were all businesses. On the other hand, a superannuation fund *Armour* v. *Liverpool Corporation* [1939] 1 Ch. 422) and a trade protection association (*In re Proprietary Articles Trade Association of South Australia Inc.,* supra n. 7) were not businesses.
85. See infra n. 110 and n. 111. See also *Dominion Iron and Steel Co. Ltd.* v. *Invernairn* [1927] W.N. 227.
86. *Rolls* v. *Miller* (1884) 27 Ch.D. 71 (C.A.), per Lindley L.J. at 88.
87. *Sykes* v. *Beadon* (1879) 11 Ch.D. 170 and *Smith* v. *Anderson* supra n. 37 (Chancery Division).
88. Supra n. 37. Gower, *Modern Company Law* (3rd ed. 1969) at 223 expresses some surprise at this result and explains the part played by this decision in the development of the unit trust. See also the Unit Trusts Act 1960 (N.Z.).
89. Ibid., 278.

trustees were held not to be carrying on a business. This decision enabled the land purchase societies[90] and a sickness insurance association[91] to avoid the consequences of section 456 by appointing trustees. Moreover, they were the types of associations which the legislature intended to prohibit.[92]

It was even suggested in *Smith* v. *Anderson*[93] that there would not have been an association carrying on a business with more than twenty trustees. It is submitted that the opportunity for avoiding the section provided by this decision cannot be justified. First, whether or not a "business" is carried on by trustees or the association itself should not alter the fact that it is a business. Yet in *Crowther* v. *Thorley*[94] the Court of Appeal felt bound to follow their earlier decision and held that the mining business of a freehold land society was being carried on by trustees so that the society was not caught by the section. Secondly, it was distinguished in *In re Thomas Ex parte Poppleton*[95] where the committee members of a money-lending club were held to be the agents and not the trustees of the members.

Finally, there is the more general point that insurance of any kind is a business. This appears to have been accepted insofar as the mutual marine insurance association in *In re Padistow Total Loss and Collision Assurance Association*[96] was concerned, but not in relation to the mutual sickness insurance association in *In re the One and All Sickness and Accident Assurance Association*[97] where Parker J. reiterated the view that even if it was a business it was being carried on by trustees for the members. It is suggested that in this case the position of the trustees should have been a factor in deciding whether or not there was a company, association, or partnership, and not decisive in resolving the "business" issue.

27. On the basis of this general approach to the definition of "business", it is difficult not to conclude that both mutual re-insurance schemes and investment clubs should be within section 456. Although the courts do not appear to have considered the position of the investment club, the view has been expressed that such a club does fit the description of a business for profit.[98]

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90. *Wigfield* v. *Potter* (1881) 45 L.T. 612, *Crowther* v. *Thorley* (1884) 50 L.T. 43 (C.A.) and *In re Siddall* (1885) 29 Ch.D. 1. (C.A.). Trustees were not even required for the land purchasing syndicate in *Ballantyne* v. *Raphael* (1889) 15 V.L.R. 538, which cannot be reconciled with *Herbert* v. *Greathead* [1936] N.Z.L.R. 185.
91. *In re the One and All Sickness and Accident Assurance Association* (1909) 25 T.L.R. 674.
92. Para. 6 ante.
93. Supra n. 37.
94. (1884) 50 L.T. 43 (C.A.).
95. (1884) 14 Q.B.D. 379.
96. Supra n. 68.
97. Supra n. 91.
98. D. B. Palo "Corporations-Investment Clubs", (1959) 31 Rocky Mountain L.R. 358 at 361, but see Josling and Alexander, *The Law of Clubs* (2nd ed. 1969) at 10.

III. THE DETERMINATION OF THE OBJECT OF AN ASSOCIATION

28. As has already been mentioned, the main task under both the Company's Act and the Incorporated Societies Act is to ascertain the object of the particular association. This task raises two important questions; first, whether gain must be the main object of the association, and secondly, whether both the rules and the activities of the association may be examined.

Gain as the main object

29. Neither of the Acts expressly requires gain to be the *main* object of the association, but section 456 prohibits an association from carrying on a business with gain as "its object". This implies that associations have one object, which will be true in the case of many commercial enterprises whose sole objective is gain or profit, but there may be some which have several objectives, including gain. There seems to be no reason why the Act should not also cover this latter type of association as long as it is distinguished from the third type which acquires gain as a result of subsidiary objects.

30. A number of *dicta* in the early company cases[99] suggest that an incidental profit acruing to an association or its members was not sufficient to bring the association within the section. Probably the most extreme example to present day minds would be *Wigfield* v. *Potter*[1] where a society, formed to purchase an estate, subdivide it, and allocate sections among its members, was held to be legal on the ground *inter alia* that any profit its members might acquire from an increase in the value of the land was

> merely an advantage obtained in acquiring for themselves what they wanted to acquire.[2]

While it may be possible to accept the argument that this scheme of purchase and subdivision was not a business because it was done once, it is difficult to agree with the judge that the profits acquired were merely incidental to the object of buying the property. This criticism does not mean that it is thought that the acquisition of "incidental" profits should automatically bring an association within the section. Rather it is considered that a profit should be clearly "incidental" before the association avoids section 456.

The majority of company cases, however, have been resolved by reference to the main object of the association which has generally been

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99. *R.* v. *Whitmarsh* (1850) 15 Q.B. 600 per Lord Campbell C.J. at 618-9 and *Smith* v. *Anderson,* supra n. 37, per Brett L.J. at 279.
1. (1881) 45 L.T. 612. cf. *Mailer* v. *Clayton* (1898) 1 W.A.L.R. 3.
2. Ibid. per Grove J. at 615.

clear. In *Shaw* v. *Benson,*[3] where the object of the society was to form a fund, the purposes of the fund were looked at to determine whether gain was one of the objects.

31. The question whether or not gain must be the main object is of crucial importance in determining whether an association is prevented from registration under the Incorporated Societies Act. This is illustrated by the University of Georgia Athletic Association which ran a laundry business on campus. Although its main object was the promotion of athletics, would the gain it acquired from its laundry business prevent it from registration as a non-profit society? The Georgia Court thought not,[4] but an American writer has pointed out that the result in this type of case will depend largely on the nature of the statutory definition of a non-profit society.[5]

32. There are two general methods used in American jurisdictions to define non-profit societies: the first is the "functional" method which enumerates the permissible objects[6] and the second is the "economic" method which is based on the economic relationship involved and includes any association not formed for the purpose of profit. It is clear that the New Zealand legislature adopted the second method when in section 4 of the Incorporated Societies Act it provided corporate status for any society of persons formed "not for pecuniary gain".

The American writer considered that the main problem with the "economic" definition was its ambiguity in that it could be construed broadly to include any association which did not acquire profits directly or pay dividends to its members, or narrowly to exclude any association which did acquire any pecuniary benefit, however indirect.[7] Clearly the answer to the main object question will depend on which construction is adopted and in the United States both views have found favour.[8]

33. In New Zealand, however, the legislature with some foresight took a unique step in the enactment of section 5 which provides:

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3. (1883) 11 Q.B.D. 563 (C.A.)
4. Supra n. 5.
5. Anon. "Nonprofit Corporations—Definition" (1963) 17 Vanderbilt L.R. 336.
6. Both of the Australian Associations Incorporation Acts referred to in n. 24 would fall into this category. For instance s. 2 of the West Australian Act defines "association" as including "churches, chapels, and all religious bodies; schools, hospitals, and all benevolent and charitable institutions; mechanics institutes, and all associations for the purpose of recreation and amusement, or for promoting and encouraging literature, science and art, and all other institutions and associations formed . . for promoting the like objects . . . " Section 4 of the present South Australian Act is similar.
7. Supra n. 5 at 338.
8. Cf. *Read* v. *Tidewater Coal Exchange Inc.* 13 Del. Ch. 195; 116 Atl. 898 (1922) (certain shippers and consignees could organise a non-profit corporation to aid the movement of coal on the ground that the corporation itself made no profit) and *Application of Pittsburgh Chevrolet Dealers' Association,* supra n. 6, (dealers not entitled to incorporation as a non-profit corporation as purpose was to increase profits of members).

> Persons shall not be deemed to be associated for pecuniary gain merely by reason of any of the following circumstances, namely:
>
> (a) That the society itself makes a pecuniary gain, unless that gain or some part thereof is divided among or received by the members or some of them:
>
> (b) That the members of the society are entitled to divide between them the property of the society on its dissolution:
>
> (c) That the society is established for the protection or regulation of some trade, business, industry, or calling in which the members are engaged or interested, if the society itself does not engage or take part in any such trade, business, industry, or calling, or any part or branch thereof:
>
> (d) That any member of the society derives pecuniary gain from the society by way of salary as the servant or officer of the society:
>
> (e) That any member of the society derives from the society any pecuniary gain to which he would be equally entitled if he were not a member of the society:
>
> (f) That the members of the society compete with each other for trophies or prizes other than money prizes.

It is submitted that the effect of this section is to explain the phrase "pecuniary gain" in broad terms. The words "merely by reason of any of the following circumstances" and subsections (a), (c) and (e) in particular, show that the Act should be construed to include any society which does not acquire gain directly for its members. As incidental or indirect gains are excluded, the Registrar or the court[9] should be concerned with ascertaining the main object or objects of the society.

34. On the basis of this interpretation of section 5, neither of the two New Zealand decisions which mention the section is entirely satisfactory. In *Hastings Volunteer Fire Brigade (Inc.)* v. *Brausche*[10] Stout C.J. compelled the trustees of the previously unincorporated Fire Brigade to transfer certain land to the Fire Brigade, which had been incorporated subsequently under the Unclassified Societies Act 1895, and in doing so rejected *inter alia* the argument of the trustees that the provisions of the Unclassified Societies Registration Act had been violated by members of the Brigade who accepted pay for attending fires:

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9. See infra para. 36.
10. (1915) 17 G.L.R. 653. See also *New Zealand Jockeys' Association* v. *Young* [1922] N.Z.L.R. 1011, where a rule which enabled the executive of the incorporated Jockeys' Association to give pecuniary relief to incapacitated jockeys was not questioned.

> I am of opinion, however, that there has been no violation by the members accepting salaries for attendance at fires. The Act is to prevent an unclassified society acting as a public company and providing for payment of profits and dividends to the shareholders . . . sections 4 and 5 of the Incorporated Societies Act, 1908, make that clear.[11]

This reason for the decision is open to three criticisms. First, the purpose of the Act is not as restricted as Stout C.J. suggests. Section 5 shows not only that other types of activity are prohibited, but also that activities which might be carried on by a public company are permitted. Secondly, it is difficult to see why the Fire Brigade should have avoided section 5(a) when as a direct consequence of its fire fighting operations its members received "gain" in the form of salaries. This situation is quite distinct from that of the University of Georgia Athletic Association which, under section 5(a), would be entitled to operate its laundry business on the side, provided no profits went to its members.

Thirdly, if the decision was based on the ground that each member of the Brigade was entitled to a salary under section 5(d), then it would open the way to considerable abuse because it would not require much ingenuity to form other "non-profit" societies in which the members received "salaries". It is suggested that section 5(d) must be limited to the case where a member is acting as the *servant* or *officer* of the society in the sense that he is employed in the administration of the society and not extended to all members who participate in the main object, such as fighting fires.

35. The second decision which mentioned section 5 was *Ashburton Veterinary Club (Inc.)* v. *Hopkins*[12] which involved the interpretation of a contract with a restrictive covenant preventing a vet from practising in an assigned area after leaving the Club's employment. The point was raised whether the Club was entitled to carry on an ordinary business venture and enter into contracts of this nature. After noting the effect of section 5(a). F. B. Adams J. went on to say:

> I can see no reason why a society should not carry on activities in the way of trade or business, or why it should not be allowed to protect itself, as the proprietor of an ordinary business may do, against unreasonable competition on the part of a former employee.[13]

Although this *dictum* supports the first criticism of Stout C.J.'s decision, it may conflict with the proviso to section 5 (c) if the Veterinary Club is described as a society regulating a calling. Section 5(c) raises the

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11. Ibid., 654.
12. [1960] N.Z.L.R. 564. Not followed on another ground in *Bush & Southern Hawke's Bay Districts Veterinary Club (Inc.)* v. *Jacob* [1961] N.Z.L.R. 146.
13. Ibid., 570.

question of trade protection associations, which has caused problems in the United States.[14] It is submitted that under section 5 the position is reasonably straightforward. While section 5(c) would permit societies such as the South Australian Proprietary Articles Trade Association and the association in *Caldicott* v. *Griffiths*[15] to register under the Act, the proviso would prevent societies such as the shopkeepers association, which ran an advertising campaign, from registering.[16]

On the other hand, trade protection associations' whose members receive pecuniary gain may be within section 5(e). This possibility was illustrated by the South Australian case.[17] Abbott J. conceded that the establishment of the trade protection association might indirectly lead to enhanced profits for its members when price fixing occurred in times of an excess in the supply of a commodity. The Registrar argued that this brought the association within the provisions of the South Australian equivalent of section 4 of the Incorporated Societies Act. After noting that the section did not contain the word "indirectly". Abbott J. concluded:

> Apart from this aspect, it is clear to my mind that if any pecuniary profit is secured to the members, such profit is secured, not from the transactions of the Association, but from the sale by the members of their own commodities.[18]

Form or substance

36. Before an association is declared to be illegal under section 456 of the Companies Act or refused registration under section 4 of the Incorporated Societies Act.[19] the court or the Registrar must actually determine whether it was formed for gain. This raises the major problem of how the object of an association is to be ascertained; whether the constitution and rules or the activities of the association should be looked at. As far as a new association or society is concerned, of course, the constitution and the rules may be the only evidence of its objects and the decision of the court or the Registrar must be based on that evidence. On the other hand, an association applying for incorporation may have already been active as an unincorporated body. In addition, most of the cases under section 456 have involved associations which have been in existence for sometime. In these circumstances the question of whether regard may be had to anything beyond the formal constitution, memorandum or articles, is vital. Can an association frame its rules so as to appear to be a non-profit organisation while in fact it

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14. For a review of the American position see the article, supra n. 5, at 340-1.
15. Supra n. 16 at p. 538 ante.
16. *Re Southside Plaza Merchants' Association* [1965] N.S.W.R. 1454. (Held an illegal association under the equivalent of s. 456 of the Companies Act.)
17. Supra n. 7 at p. 537 ante.
18. Ibid., 93.
19. Once a society is registered the Registrar may change his mind if he is satisfied that it was registered by reason of a mistake of fact or law: s. 28. See also s. 20, infra para. 40.

carries on a business for gain? An American example is the Ohio real estate business which applied for incorporation as a non-profit corporation on the basis of a charter which declared that its purpose was to "promote the social welfare of the community."[20]

37. In several of the cases where it was argued that the association was illegal the courts have been able to answer the question simply by looking at the form of the association. For instance, societies whose rules provided for interest bearing loans to their members were held to be clearly illegal[21] and a scheme which proposed a partnership between an incorporated company and individuals for sharing the profits of a banana-growing venture was considered to be within the equivalent of section 456 after a perusal by the court of the prospectus circulated by the company.[22]

38. In some cases, however, an association was able to rely on its form to retain its legality. In the leading case of *Smith* v. *Anderson*[23] the court was faced with a deed of trust under which a large number of subscribers invested money in what were described as "a large number of different independent securities of a hazardous description".[24] The basis of the investment was that under the doctrine of averages the loss on some of the "securities" would be compensated by the gain on others. The trustees were given very limited powers of investment, sale and re-investment and there were complicated provisions whereby the subscribers or certificate holders ultimately received all the profits. The action was brought by one of the certificate holders on behalf of himself and the other holders against the trustees claiming that because the association was illegal it should be wound up and its funds distributed.

Jessel M.R. had no difficulty in finding for the plaintiff certificate holder on the ground that the prospectus and the deed of the association clearly showed that it had been formed for the acquisition of gain. The Court of Appeal, however, went no further than the trust deed and concluded that the scheme was not illegal on the grounds that the deed disclosed no association between the certificate holders, its object was not to carry on a business but to manage a trust fund, and even if there was a business it was being carried on not by the certificate holders but by the trustees of whom there were fewer than twenty.

Even if the court correctly construed the trust deed, it is difficult to accept that in substance the certificate holders were not in fact carrying on an investment business for the purpose of acquiring profits. Although this reliance on the form of the association by the Court of Appeal enabled societies formed to purchase blocks of land to avoid the

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20. *State ex rel. Russell* v. *Sweeney,* 153 Ohio St. 66; 91 N.E. 2d. 13.
21. *Shaw* v. *Benson,* supra n. 3, and *Greenberg* v. *Cooperstein,* supra n. 72.
22. *Sunkissed Bananas (Tweed) Ltd.* v. *Banana Growers' Federation Co-operative Ltd.* (1935) 35 S.R. (N.S.W.) 526, and casenote in (1936) 9 A.L.J. 370.
23. Supra n. 37. See also discussion para. 25 & 27 ante.
24. Ibid. per James L.J., at 276.

effect of section 456 by establishing a deed of trust,[25] it was not accepted without criticism. In the Court of Appeal in *Crowther* v. *Thorley*[26] Lord Coleridge C.J. said:

> Now that brings me to the case of *Smith* v. *Anderson* and as to that case . . . I am free to confess that there would seem to me great force in the argument that this putting forward mere trustees to carry on the business is a mere evasion of the statute . . .[27]

In spite of these strong words, however, he felt bound by *Smith* v. *Anderson* a view which was naturally shared by Brett M.R. as well as Bowen L.J. A similar approach was adopted in *In re Siddall*[28] when each member of the Court of Appeal with some reluctance expressed himself bound by the earlier decisions.

39. The approach based on the form of an association is parallelled by a number of decisions where the judges have not adopted this restrictive attitude, but have considered the actual activities of the association. In the two mutual marine insurance association cases[29] some of the judges did not hesitate to mention the activities of the associations, although in fact in these cases the rules would have been sufficient to show that the associations were illegal. A similar attitude appears to have been adopted in two Australian cases[30] where the objects of an association which ran a sheep dip and the objects of an advertising association of shopkeepers were ascertained with reference to the activities of the respective associations.

In the former case reference was made to a test proposed by Simonds J. in *Armour* v. *Liverpool Corporation*[31] where he said:

> Neither "business" nor "gain" is a word susceptible of precise or scientific definition. The test appears to me to be whether that which is being done is what ordinary persons would describe as the carrying on of a business for gain . . .[32]

Applying this objective test he decided that the superannuation fund established for the tramway employees of the Liverpool Corporation was not within the section. Although it has been pointed out that this objective test is not without difficulty,[33] it is suggested that its acceptance would enable the courts to consider the activities as well as the rules of associations.

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25. Supra n. 90.
26. Supra n. 94.
27. Ibid., 45.
28. (1885) 29 Ch.D. 1.
29. *In re Arthur Average,* supra n. 61, and *In re Padstow,* supra n. 68.
30. *In re Riverton Sheep Dip* [1943] S.A.S.R. 344, and **Re Southside Plaza Merchants' Association** [1965] N.S.W.R. 1454.
31. [1939] 1 Ch. 422.
32. **Ibid., 437.**
33. See Gower, *Modern Company Law* (3rd ed. 1969) at 222 (n. 29).

40. As far as associations applying for registration unnder the Incorporated Societies Act are concerned, it is submitted that this objective aproach should be adopted. Positive support for this view appears in section 20(1) which provides:

> No society shall do any act of such a nature that if the doing thereof were one of the objects for which the society was established the members of the society would be deemed to be associated for pecuniary gain within the meaning of sections four and five hereof.

If the activities of a society may be examined once it is incorporated to see whether it is formed for pecuniary gain,[34] this would seem to be a strong argument in favour of the opinion that the activities, if any, of an unincorporated association may be examined before registration.

41. Although the Registrar has presumably considered this matter on occasions, there are no reported New Zealand cases in point. The Ohio Supreme Court, however, in the real estate business case, decided that the statement in the Charter was not conclusive and that the real test was the actual character of the proposed corporation.[35] Further support for this approach comes from a number of club cases in the taxation field where the form or substance problem has directly arisen.

As clubs are by definition[36] not formed for the acquisition of gain, they would never be liable for taxation if a purely formalistic approach was adopted. The cases, however, support a substantive approach. In *Carlisle and Silloth Golf Club* v. *Smith*[37] a golf club was held to be liable for tax on fees which is received from members of the public who used its course for the reason that it was really carrying on the business of supplying a recreation ground to the public for reward. In contrast to this, in *Inland Revenue Commissioners* v. *Eccentric Club Ltd.*[38] it was held that an incorporated members' social club which made a surplus for the year in question was not carrying on an undertaking similar to a business and was not liable. In arriving at this decision Warrington L.J. said:

> What is in fact being carried on, putting technicalities aside, is a members' club and not a proprietary club, nor any undertaking of a similar character. That in such a case one may go behind the technicalities and look at the substance is, I think,

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34. The question of whether the *ultra vires* doctrine applies to incorporated societies is beyond the scope of this paper. It is accepted that in general it does not apply to unincorporated associations: Lloyd, *Law of Unincorporated Associations*, at 142, or at least vis a vis third parties: Josling and Alexander, *The Law of Clubs* (2nd ed. 1969) at 20.
35. Supra n. 20.
36. *In re St. James's Club* (1852) 2 De G. M. & G. 383, and see supra n. 12.
37. [1913] 3 K.B. 75 (C.A.)
38. [1924] 1 K.B. 390 (C.A.).

shown by the mode in which the House of Lords dealt with a question, similar in this respect, in *New York Life Insurance Co.* v. *Styles.*[39] [40]

The same conclusion had already been reached by the High Court of Australia[41] so that there is a strong argument by analogy that if the substance approach is adopted to ascertain the nature and objects of a club for tax purposes, then the same approach should be adopted for ascertaining the same objects for incorporation purposes. There seems to be no reason why in this area the purpose should have any effect on the approach.[42]

IV. SUMMARY

42. In comparing the legal status of those associations which must avoid the prohibition of section 456 of the Companies Act 1955 in order to remain unincorporated and those which seek corporate status through registration under the Incorporated Societies Act 1908, it is apparent that the decisive factor in each case is the presence or absence of "gain". The background to this is to be seen in the common law distinction between the partnership and the non-trading club which in turn is the basis for the subsequent legislative history of the respective provisions.

The combined effect of the two statutes is to produce a broad division between commercial and non-commercial associations because section 456 limits the size of unincorporated commercial associations, while section 4 of the Incorporated Societies Act provides for the incorporation of non-commercial associations. The result is that a non-commercial association, which is refused registration under the latter Act, may still not be within section 456.[43]

The word "gain", therefore, must be construed in the context of each statute and on the basis of this broad division. Under section 456 a general definition has been adopted so that "gain" covers the acquisition of advantages or resources and is neither limited to profits in an accounting sense nor avoided when a loss is incurred on a year's activities. A narrower definition has been used in section 4 because the gain must be "pecuniary", but apart from this important qualification it is probably open to a similar interpretation.

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39. (1889) 14 App. Cas. 381 (H.L.).
40. Supra n. 38 at 421-2. The substance approach in taxation cases (*I.R.C.* v. *Blott* [1921] 2 A.C. 171) is not always accepted (*I.R.C.* v. *Duke of Westminster* [1936] A.C. 1.), but the present trend appears to place the emphasis on the substance of the transaction (*Elmiger* v. *C.I.R.* [1967] N.Z.L.R. 161).
41. *Bohemians Club* v. *Acting Federal Commissioner of Taxation* (1918) 24 C.L.R. 334.
42. The view that the courts should examine the activities as well as the expressed objects of associations is related to the wider questions of the *ultra vires* doctrine and the *substratum* rule which are not dealt with in this paper.
43. [1913) 3 K.B. 75 (C.A.).

In ascertaining whether or not an association is formed for gain under either Act, the objects of the association must be determined. The question is whether this inquiry is related only to the main objects or is extended to subsidiary objects, as well as to the indirect gain of an association. As most commercial associations have gain as their main objective there will generally be little difficulty in determining whether associations of this nature are within section 456. The position of the rare commercial enterprise which acquires gain only as a result of a subsidiary object is not clear, but it is considered that section 456, which refers to "its object", is concerned with the main object of associations and profits should be clearly incidental to avoid the section.[44]

As far as incorporated societies are concerned, the experience of the various American jurisdictions and the two New Zealand decisions on the point suggests that more difficulties are likely to occur with non-trading associations which acquire gain for their members, directly or indirectly, or which run profitable businesses on the side. Yet, it is submitted, there need be few difficulties if a straightforward interpretation of section 5 of the Incorporated Societies Act is adopted. This section shows that the Act is concerned with determining the main object because it distinguishes between gain received by the members of an association as a result of its activities and gain received by the association from a profitable subsidiary activity and used to further a principal non-profit object.[45]

The final question in determining the object of associations is whether both their form and substance may be examined. This question is of importance in relation to associations which frame their constitutions or rules so that their expressed objects appear to be non-profit, while in fact their activities show that gain is their object. The same problem may arise to a lesser extent in the case of a non-profit association which does not exercise the express powers under its rules to acquire gain. Although the cases under section 456 which follow *Smith* v. *Anderson*[46] suggest that a non-profit form may be sufficient to avoid the prohibition in the section, it is really an artificial approach to rely on the stated objects in the rules when the association is in fact carrying on profitable activities. An objective approach which enables the court or the Registrar to examine the real position is preferred. Section 20 of the Incorporated Societies Act and the club taxation cases support this this view, which, it is submitted, leads to an accurate determination of the dividing line between associations formed for "gain" and those formed for some other purpose.

D. J. White.*

44. This was the view of the South African court in *South African Flour Millers' Mutual Association* v. *Rutowitz Flour Mills Ltd.* [1938] S.A.L.R. (C.P.D.) 199, 205.
45. Two taxation examples of associations which acquired profits for principal charitable purposes are *C.I.R.* v. *Peeblesshire Nursing Association* 1927 S.C. 215, and *C.I.R.* v. *Falkirk Temperance Cafe Trust* 1927 S.C. 261.
46. (1880) 15 Ch.D. 247.

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