Clubs Australia

Not-for-Profit Sector Taxation Working Group

Clubs Australia Submission

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Executive Summary

The Australian club industry is represented by a diverse range of entities established as member-owned and operated, not-for-profit bodies designed to promote or pursue a common purpose. Clubs are often established for sporting purposes, but also exist for veterans' affairs, workers' groups and ethnic communities. There are approximately 6,500 clubs in Australia, generating a $7.2 billion economic contribution and a $2.3 billion social contribution to the nation annually. The club industry is diverse in terms of size, membership and profitability. A handful of the largest clubs has more than 100,000 members and earns revenue of more than $50 million per annum. The majority of the industry, however, is represented by clubs with small membership, few employees, minimal revenue and some form of financial distress.

As member-owned not-for-profits, clubs enjoy the principle of mutuality, and income derived for their members is not assessable for tax purposes. Additionally, many clubs established to promote sport are income tax exempt under the provisions of the *Income Tax Assessment Act 1997*, Division 50-45. Clubs do pay a variety of taxes, however, and in 2011 the industry contributed around $2.4 billion to government revenue, not including GST receipts.

In its 2008 review of the clubs industry, the NSW independent Pricing and Regulatory Tribunal thoroughly examined the social contributions of the industry and compared it with the level of government support and concessions it received, and concluded that the positive contribution made by clubs justifies the government action.

The Working Paper has not raised any issues that have not already been covered by other reviews of mutuality, including by the Ralph report, the Productivity Commission and the Henry review. The Government continues to reject any changes to the principle of mutuality and its application, in particular, to licensed clubs. Most recently, in announcing its proposed amendments to the calculation of income tax for the not-for-profit sector in May 2011, the Government once again reaffirmed that its reforms would not affect the principle of mutuality.

Many of the Working Paper's concerns about ambiguity surrounding mutual income calculations and the expensing of deductions for taxation purposes are out of date, given that the Australian Taxation Office has produced clear guidance to not-for-profit clubs in their publication *'Mutuality and taxable income'.* This guidance has provided the industry with greater certainty on the application of issues such as the taxable status on temporary member income, and the allowance or apportionment of deductions against assessable income.

In the context of on-going dialogue and consultations between the Australian Taxation Office and the clubs industry represented in the Clubs Consultative Forum, the ATO has not raised any concerns with respect to the behaviour of clubs in assessing, reporting or paying their tax obligations, and have raised no concerns about widespread evasion or non-compliance. As such, it is our view that nothing in this discussion paper would warrant re-examining the application of the more that 120-year old common law principle of mutuality for licensed clubs in Australia, and the tax treatment of clubs' mutual receipts continues to assist in supporting their socially desirable purpose in providing sporting, recreational, charitable and community services in the creation of social capital and a vibrant civic society.

Mutuality

The mutuality principle is a legal principle inherited from English common law and established by Australian case law. It is based on the proposition that an organisation cannot derive income from itself. This includes where persons who contribute to a common fund controlled by them, that any surplus is for the common purpose, and is not income.

2. The High Court first considered the principle of mutuality in relation to clubs in *Bohemians Club v Acting Federal Commissioner of Taxation* (1918) 24 CLR 334. Australian courts have consistently found that the mutuality principle applies within the context of Australian taxation law. Some entities have been excluded from the application of mutuality by specific income tax provisions, such as life insurance companies, certain friendly societies and cooperatives and mutual insurance companies and credit unions.

3. The current taxation treatment of clubs by the Australian Taxation Office is outlined in its publication *Mutuality and Taxable Income*.[1] The guidance advises that registered and licensed clubs meet the characteristics of organisations that are mutual, in that:

- Clubs operate for the benefit of members collectively, not individually;
- Clubs members share a common purpose; and
- Club members have ownership and control over the club and its fund.

4. Receipts derived from mutual dealings with members are not exempt income, but non-assessable income.

Previous consideration of mutuality

5. The Australian Parliament has had many opportunities to decide to legislate upon the issue of mutuality for licensed clubs and has chosen not to do so.

6. In its 1999 inquiry into gambling, the Productivity Commission examined the issue of mutuality in the club industry and examined a number of options governments could consider if they perceived there were policy reasons why clubs should not be extended preferential regulatory and taxation treatment. In the end, the Commission identified that state and territory governments were best placed to impose the appropriate levels of gambling taxation levels on clubs. This option has left individual state and territory governments to decide the optimal regulatory framework for the club industry in their respective jurisdictions, without affecting the principle of mutuality.

7. The *Review of Business Taxation* in 1999 (also known as the Ralph report) also made two recommendations with respect to the principle of mutuality – that it be codified in legislation, as distinct from its current common law status, and that there be appropriate provisions to ensure apportionment between mutual and taxable income. The report gave no reasons for these recommendations. As to the first point, the Government has not chosen to codify the principle of

[1] http://www.ato.gov.au/content/downloads/NFP00246017.pdf

mutuality, as it currently exists and operates, although Clubs Australia would support this in principle. However, in response to the Full Federal Court decision of *Coleambally Irrigation Mutual Co-operative Limited v FCT* [2004] FCAFC 250, legislated to ensure that the taxation status of mutual non-profits was protected, with bipartisan support. As to the second point, guidance from the Australia Taxation Office has clarified any ambiguity surrounding the appropriateness of apportionment for mutual and non-mutual income and corresponding deductions.

8. The *Australia's future tax system report* (also known as the Henry tax review) examined the issue of mutuality and recommended that simple and efficient tax arrangements should be established for clubs with large trading activities in the fields of gaming, catering, entertainment and hospitality. It raised as one possible option the imposition of a concessional rate of tax to total net income from these activities above a high threshold. In response, on 10 May 2010, Prime Minister Rudd and Treasurer Swan explicitly ruled out any changes to the tax system that would harm the not-for-profit sector, including removing the benefit of tax concessions or changing income tax arrangements for clubs.

9. Most recently, in announcing its proposed amendments to the calculation of income tax for the not-for-profit sector in May 2011, the Government once again reaffirmed that its reforms would not affect the principle of mutuality.[2]

The concerns raised by the Working Group paper

10. The paper asserts four concerns about the principle of mutuality:

- Uncertainty and complexity in tracking mutual and non-mutual income
- Competitive neutrality
- Social policy concerns
- Concerns about the application of income from temporary memberships as mutual income.

11. Although these concerns are listed, the paper does not go into any detail to explain why the authors believe these are concerns, and how these concerns are explicitly linked to mutuality. More generally, the paper claims that clubs do not face the same restrictions as charities in spending their income for charitable purposes; however, this comparison is false, as the income from charities is not derived from members, and as the Australian Taxation Office has explained, mutual receipts or surpluses are not income per se, and cannot be compared to income earned by charities. Clubs' expenditure of member receipts is also subject to the endorsement of the membership itself, and surpluses are used to pursue the objectives of the club that members have chosen to join. It is incorrect for the paper to assert that the accumulation of surpluses could be a perceived 'private benefit'; all clubs are established on the principle that there are no individual or private benefits, but they are formed around a common purpose, such as the RSL fraternity or a sporting code.

[2] http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/077.htm&pageID=003&min=brs&Year=2011&DocType=0

Uncertainty and complexity in tracking mutual and non-mutual income

12. The tracking of mutual (member) income and non-mutual (non-member) income for clubs is neither uncertain nor complex, but a standard operating requirement under state and territory-based legislation. When entering a club, members must show club identification (e.g. a membership card) while non-members must be signed in as temporary members or guests. Each state and territory places restrictions on clubs about the application of temporary membership, and for taxation purposes, neither temporary members' nor guests' expenditure can be considered mutual income.

13. The Australian Taxation Office has issued clear, industry-specific guidance to clubs in how to apportion revenue that comprises both assessable and non-assessable income. Clubs have flexibility in using an appropriate apportionment method that best suit their circumstances. Where the separation of apportionable revenue and expenses is involved, a formula known as the Waratah's formula, derived from case law, has been accepted as a reasonable basis for apportionment, and only requires clubs to maintain daily member attendance, members' guests, and total visitor numbers to be kept.

Competitive neutrality

14. Again, the paper makes the assertion that there are concerns around competitive neutrality without providing any detail, other than to say that businesses which carry out trading activities in competition with clubs may be disadvantaged. In practice, this would be other members of the hospitality industry, in particular hotels, bars and restaurants. For gaming, however, this now extends to providers of online gaming.

15. Due to their nature, licensed clubs have significantly higher compliance and operational requirements – and therefore costs – than for-profit competitors. Clubs in most jurisdictions have industry-specific legislation which prescribes accountability and governance provisions which mandate additional compliance activities for clubs, e.g. under the Registered Clubs Act (NSW) 1976, the legislation prescribes compliance obligations under Parts 4 and 4A around issue of management, financial interests and the dealing of property, loans and remuneration. Clubs also have costs in maintaining their mandated community grants programs in each jurisdiction.

16. In its examination of the industry in 2008, the NSW independent Pricing and Regulatory Tribunal found that clubs are not focused on maximising profit in the same way as a commercial enterprise:

> *Club members only benefit from the profitability of the club to the extent that ongoing profitability contributes to the continuation of the club as a going concern and improvement of facilities, goods and services offered by the club to its members.*

17. State and territory governments explicitly choose to differentiate between clubs and pubs in a number of ways that may affect competition. For example, in Queensland, only pubs may operate drive in and detached bottle shops; and corporations, such as Woolworths and Coles, may own an unlimited number of gaming machines spread among their pubs, whereas clubs are limited to 280 machines, irrespective of the number of venues under their control. In many states, clubs are at a

disadvantage in their ability to borrow in order to undertake capital expenditure, for example because they do not own the land on which they operate. Club members do not have the same proprietary rights as owners of private enterprises and cannot transfer their rights. Clubs have additional obligations to community funding, not imposed on for-profit operations. Given the differences that occur among different jurisdictions, issues of competitive neutrality are best left to the state and territory governments that have primary carriage in the regulation of the hospitality industry.

18. As competitors with providers of online or internet-based gaming, clubs are at a substantial disadvantage. While Australian-based companies are unable to provide online gaming (as opposed to wagering and sports betting), overseas-based companies earn significant amounts of revenue from Australian consumers, which is both unregulated and untaxed. As internet gaming becomes more widespread, and its delivery through mobile technology expands, clubs will face further competitive pressures that will not be assisted through a change in treatment of the principle of mutuality.

19. The paper also raises competitive neutrality in the context of fringe benefit tax concessions, and claims that restaurants and bars may be disadvantaged with respect to rebateable clubs. In fact few clubs are eligible for FBT concessions, and in cases of eligibility, the claimable amount is not significant, given that FBT cannot be claimed against mutual income. In practice, the size and scope of eligible sporting clubs would mean that they do not have the financial resources to provide fringe benefits to staff.

Social policy concerns

20. The paper asserts that one of the concerns about the principle of mutuality related to social policy concerns given that much revenue in the club industry is derived from alcohol sales and gaming. However, the paper fails to explain why concerns around the impact of gaming and alcohol consumption should be addressed by interfering with the common law principle. In fact, governments address social policy concerns through a range of regulatory options. In practice, in providing gaming and alcohol, clubs already face a number of licensing conditions and other regulatory requirements, as well as specific levies and taxation in relation to these products. It is unclear why governments need to modify the principle of mutuality when there are other regulatory and taxation tools at their disposal.

21. Additionally, government have made a conscious decision to provide clubs with licences to provide liquor and gaming for the express purpose of funding affordable infrastructure for sports and veterans' services that would otherwise have to be provided by government. The club movement was delegated this responsibility given its extensive reach, its sense of inclusion and participation from its membership-based model, and its not-for-profit status.

Application of income from temporary memberships as mutual income

22. The paper raises concerns that there may be ambiguity as to whether receipts derived from temporary members should be considered mutual. However, the Australian Taxation Office guidance is clear that such income is not mutual. The guidance states:

> *A non-member is someone who is not a member of the organisation. Non-members include:*
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> - *temporary, honorary, social and reciprocal members who have not been through the … membership process and are treated as visitors*
> - *members' guests – those visitors who accompany a member and are signed in by the member*
> - *other visitors.*

23. These guidelines require clubs to keep records of the number of members and non-members attending the club throughout the year. Clubs Australia does not believe that temporary membership receipts should be counted as mutual income, and that the current arrangements are satisfactory.

Case Studies

24. The impact of removing mutuality from club income tax provisions would have dire results for many smaller clubs in regional and rural areas. For example, Cooma ex-Services Club is not income tax exempt, and in FY2012, from revenue of $3.4 million, ended with a net profit before tax of $300,000. Had mutuality not been applicable, it would have had a tax bill of $100,000. However, as this tax was saved, the club was able to make more than $56,000 in donations to local charities and sporting groups, while having a small surplus to save for future capital expenditure. The principle of mutuality allows this club to keep operating. Similarly, the Murwillumbah Services Memorial Club earned in FY2012 revenue of $5.2 million, which after depreciation and operating and financial expenses, resulted in a pre-tax surplus of just $35,000. Without mutuality, it would have paid an additional $10,000 in income tax. With mutuality, however, it was able to accrue a small tax benefit that it can utilise to reduce income tax payable in future years.

Anti-avoidance rules

25. The paper raises the question about the possible enacting of anti-avoidance rules to address concerns about tax evasion, without providing any evidence of tax evasion by mutual organisations, particularly licensed clubs. As discussed earlier, income derived from temporary membership has been identified as assessable income. As an on-going member of the Clubs Consultative Forum, the Australian Taxation Office has never raised with Clubs Australia any concerns about widespread or on-going tax evasion by the club industry detected through its compliance scoping projects, compliance audits and compliance programs. Clubs Australia rejects any assertion made that the industry exploits mutuality to evade tax.

26. Additionally, clubs are usually companies limited by guarantee or incorporated associations, and subject to general purpose audits which most similarly-sized for-profit organisations are not. Clubs are also subject to member scrutiny, and members must be able to access financial data, e.g. in New South Wales clubs must provide quarterly financial data to members, in addition to annual financial data. Therefore the scrutiny of club finances is already much more detailed than for sole traders, partnerships, trusts and proprietary limited companies.

Income tax exemption for sporting clubs

27. Licensed clubs in Australia provide extensive sporting infrastructure for the Australian community, often provided at below-market rates. In 2011, it was estimated that 2,840 clubs provided bowling greens, 1,450 clubs provided gold courses, 1,130 clubs provided carpeted bowling facilities, 580 clubs provided tennis courts and 300 clubs provided gyms or fitness centres. Add to this the many hundreds of sporting fields developed and maintained by clubs involved in rugby league, rugby union, Aussie Rules, soccer and hockey which cater for the hundreds of thousands of players that participate in those sports. Just as important as providing these tangible assets, clubs are the irreplaceable conduit and lifeline for the huge army of volunteers that are needed, week in week out, to provide sporting opportunities for Australians of all ages. This huge and cost efficient sporting infrastructure is beyond the logistical and financial capability of government.

28. Eligible sporting clubs provide the majority of their surplus revenue, after operational and maintenance expenses, to their sporting purposes, and those with extensive commercial trading already do not qualify for the sporting club exemption. Most sporting clubs that are income tax exempt are small in nature and would often struggle to make a profit of any significance. Additionally, the Government is currently modifying the tax assessment procedures for the operating surpluses of all not-for-profit entities through its *Better Targeting of Tax Concessions* reform process.

29. Clubs Australia believes that participation in sport and exercise has never been more important, particularly with the high incidence of obesity in young people. Sporting clubs provide substantial public benefits to the Australian community in this regard, including:

- physical and psychological benefits
- increased social interaction
- reduced antisocial behavior by those participating in sport
- reduced healthcare costs.

Therefore, there is no doubt that tax exemptions for sporting clubs are appropriate and should continue.

30. Non sporting clubs also provide numerous benefits to their members and to the communities in which they serve. For instance, RSL & Services Clubs donate funds to their sub branches which provide extensive welfare services to returned servicemen and women throughout Australia. They provide ambient facilities for serving and returned service personnel to meet and interact with their friends. They organise and participate in important commemorative events honouring the fallen and injured on such occasions as Anzac Day and Remembrance Day. Many clubs provide free transport

to and from the club, which means that elderly and people with disabilities who would otherwise be socially isolated are also able to enjoy meeting in a climate controlled and ambient environment.

31. In this regard, Australia's social and sporting clubs are unique in the world. Similar facilities in other countries are inaccessible to the majority of the community and are the haven of the wealthy because such facilities in these countries have prohibitive joining and membership fees.

32. Clubs Australia strongly believes that there is no reason to change the application of the principle of mutuality as it currently applies to not for profit community clubs.