Clubs Australia

Re:think Tax Discussion Paper

Clubs Australia Submission – June 2015

Executive Summary

Clubs Australia welcomes the opportunity to comment on the Federal Government's taxation review.

We understand the need for a taxation system that delivers fairness and keeps pace with technological developments. Clubs are unique in the Not for Profit (NFP) sector because they do not rely upon government funding, external grants or donations, but undertake substantial commercial activity to remain self-sustaining.

Clubs Australia is firmly of the view that existing tax arrangements, as they relate to clubs, should remain in place and unchanged to allow clubs to remain economic contributors to Australia.

The revenue from clubs is believed to account for around 20 per cent of the entire NFP sector's non-government income.

Unlike other NFPs, clubs pay a range of Commonwealth, state and local government taxes and charges. Clubs pay an estimated $2.4 billion in tax each year. Clubs operate under the well-established legal principle of mutuality (each venue carries out a common purpose for the benefit of members collectively, not individually).

In addition, some clubs are classified as exempt institutions under the Income Tax Assessment Act 1997 because their main purpose is to encourage sport, a socially desirable outcome.

The tax status of clubs reflects their role in building social capital and contributing to local communities; each year, clubs make a social contribution valued at $2.3 billon.

It is estimated that approximately 2,840 licensed clubs provide bowling greens, 1,450 offer golf courses, 580 provide tennis facilities and 710 provide sporting fields for use by members and the local community. These assets are spread across metropolitan and regional Australia.

The role of clubs in the Australian community

Clubs Australia represents Australia's 6500 licensed clubs, with around 12 million club memberships. Clubs are not-for-profit community based organisations which provide infrastructure and services for their members and the community. Clubs contribute to their local communities, through employment and training, direct cash and in-kind social contributions and through the formation of social capital by mobilising volunteers and providing a diverse and affordable range of services, facilities and goods.

Clubs are unique in the NFP sector as they do not rely upon external grants or donations to sustain their operations and are highly accountable due to the legislative requirements for the provision of food, beverage and entertainment services. The revenue from clubs is believed to account for around 20 per cent of the entire NFP sector's non-government income.

The level and type of community service that the Club Movement provides is evolving to meet emerging societal challenges like the housing of our growing aged population, the shortage of affordable child care services and employment of disadvantaged communities such as the disabled, indigenous, elderly and single mothers.

According to the 2011 Census of clubs by KPMG the Club Movement makes a direct national social contribution of more than $2.3 billion annually. This is in addition to the more than $7 billion dollars in economic contribution generated by clubs annually nationwide. Furthermore, registered clubs in

Australia directly impact employment with clubs employing approximately 96,000 people across a variety of roles and in addition to direct economic contribution clubs also have an indirect impact on the state, territory and national economy.

Australia's clubs mobilise more than 100,000 volunteers. Volunteering builds social capital. It provides significant benefit to the volunteers themselves by increasing their sense of belonging and contributing to their community, by facilitating new friendships, and by developing and maintaining skills. Clubs act as an important catalyst and organising force for people to find causes to which they can devote themselves. The KPMG census calculated volunteer time contributed by clubs in 2011 at almost 5.9 million hours within the club sector across Australia.

Over 90 per cent of Australian clubs provide sports facilities to members, including 1621 bowling greens, 338 golf courses, 102 gyms and 325 sporting fields in New South Wales alone. In many rural and regional areas, clubs provide the only sporting infrastructure available in the town. It is estimated that Queensland clubs generated 51.64 million active hours in participation in social and organised sports and leisure activities in 2008. Clubs also provide members with access to recreational facilities at rates which are usually considerably less than commercial prices. In addition to the sense of community created by professional sporting teams, participation in nonprofessional sport has an important role in promoting community unity and improving the physical health of participants.

Current taxation arrangements for clubs

Clubs pay a range of Commonwealth and State and Territory Government taxes and charges, including gaming machine tax, goods and services tax, payroll tax and fringe benefits tax. KPMG found that Australian clubs pay more than $2.4 billion in State, Territory and Federal taxes each year.

In general, clubs are regarded as companies for income tax purposes and their income is subject to the prevailing company tax rate of 30 per cent. However, there are certain exceptions. Division 50-45 of the Income Tax Assessment Act as further governed by the Commissioner of Taxation in Tax Ruling TR97/22 'Income tax: exempt sporting clubs' allows for certain sporting clubs to be exempt from income taxation. Division 50-10 of the Income Tax Assessment Act nominally offers the same exemption to community service clubs, though very few, if any, clubs have utilised this clause. These exemptions are generally given or reassessed on an annual basis and clubs must meet the criteria each year in order to receive the exemption. The incentive provided through the sporting club tax arrangement is achieving the worthy goal of building and maintaining sporting infrastructure and encouraging community participation in sport and healthy lifestyles.

This activity by clubs alleviates governments of the need to allocate the significant sums of money required to provide sport to the community, encourages volunteerism through clubs, ensures support is realised locally throughout the country and, through increased sporting participation helps reduce the incidence of obesity and other health risks. Governments of all persuasions have recognised the benefits that have flowed to the Australian community through professional and amateur sporting achievement that would never have occurred but for the opportunities provided by not-for profit sporting clubs.

Proving eligibility to the ATO is not easy. A careful assessment is needed to be undertaken in regard to all of a club's activities, including non-sporting, before a decision can be made whether 'encouraging sport' is the club's main purpose. A club which sought to undertake large, non-sporting expenditure (altruistic or otherwise) would also face a challenge to prove that its main purpose remained the encouragement of sport.

Mutuality

Clubs are mutual entities and 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.

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.

The current taxation treatment of clubs by the Australian Taxation Office is outlined in its publication Mutuality and Taxable Income. 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.

Receipts derived from mutual dealings with members are not exempt income, but non-assessable income. Clubs Australia strongly believes mutuality remains a valid and necessary tax policy for clubs.

> **Over the years Australian Governments have consistently expressed support for the continued application of mutuality to clubs.**

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 mutuality, as it currently exists and operates, although Clubs Australia would support this in principle.

It should be noted that in response to the Full Federal Court decision of Coleambally Irrigation Mutual Co-operative Limited v FCT [2004] FCAFC 250, the Australian Government legislated to ensure that the taxation status of mutual non-profits was protected, with bipartisan support. As to the second recommendation, guidance from the Australia Taxation Office has clarified any ambiguity surrounding the appropriateness of apportionment for mutual and non-mutual income and corresponding deductions.

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.

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.

It is self-evident that if changes are made to club taxation arrangements in a way that seeks to increase the tax take, clubs would alter their behaviour to reduce available surpluses. Such responses are likely to have adverse effects on employment and investment, and reduced support for community and sporting activities, unless such assistance was substituted by Governments or the private sector.

Income tax exemption for sporting clubs

Licensed clubs in Australia provide extensive sporting infrastructure for the Australian community. 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.

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.

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 behaviour by those participating in sport
- reduced healthcare costs.

It is the view of Clubs Australia that the policy underlying the sporting club tax arrangement of Division 50-45 of the *Income Tax Assessment Act 1997* is still valid and should be supported.

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.

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.

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.

Competitive Neutrality

It has been suggested by some that clubs' tax arrangement should be altered to achieve competitive neutrality. It should be noted that NFPs are not the only entities to receive concessional tax rates that might be affected by strict application of the competitive neutrality principle. Small businesses in most jurisdictions are eligible for an exemption from payroll tax that competing medium and large sized businesses cannot claim.

> **Clubs Australia believes the structure of NFPs means they trade at a commercial disadvantage compared with for-profit (FP) entities and that, combined with their obligation to advance the social good, justifies the tax concessions to which NFPs are entitled.**

It is worth noting that both the Henry Review and the Productivity Commission's report into the not-for-profit sector both found that income tax concessions for the NFP sector do not generally violate the principle of competitive neutrality where NFPs operate in commercial markets, even after examining the implications of the Word Investments judgment. The Productivity Commission found that NFPs have greater difficulty than commercial entities in accessing credit for investment and that the income tax exemptions help to level the playing field.

In the case of NFP entities, the objective of profit maximisation is to invest in social and charitable activities while, in the case of FP entities, the objective of profit maximisation is to remunerate owners to the greatest extent possible. Both NFP and FP entities act to maximise their output (profits) for a given level of inputs (costs). How that output is treated by taxation authorities should not dilute the profit maximisation objective.

As a consequence, the output-based tax exemptions granted to clubs would not be expected to distort resource allocation or reduce competition. For example, it is quite evident that tax concessions to clubs on gambling revenue do not reduce the cost of purchasing or operating gambling machines.

Indeed, this is contrary to the financial challenges that many clubs are currently facing, such as reluctance by banks to lend to the industry. With declining cash earnings and the current economic conditions, clubs have a reduced capacity to reinvest. Over time, this leads to deteriorating facilities and clubs losing their market appeal, thereby exacerbating declining trading performance. With an increasing number of clubs experiencing financial decline and the industry seen as having an uncertain future, banks are either reluctant to lend to the industry or will do so with onerous and restrictive covenants.

Clubs Australia submits that clubs face enormous challenges to diversify their operations and that the tax position of clubs does not directly alleviate this challenge.

ClubsAustralia believes the structure of NFPs means they trade at a commercial disadvantage to for-profit entities and that, combined with their contribution to the social good, justifies the tax concessions NFPs are entitled to.

Most NFPs do not make their own income, it is sourced instead through either Government grant or private, charitable donation. Neither of these sources is open to registered clubs, nor are they seen as reliable income on a long term basis even if they were available to clubs.

Income from other sources will, almost by definition, be through some form of competition with potential private sector operators. Examples include Salvation Army clothing stores, Cancer Council sunscreen and Country Women's Association bake sales. Competing clothing stores, sunscreen manufacturers and bakeries might well argue that these charities have an unfair competitive advantage through tax breaks, volunteer staffing or general community goodwill. While not on the same scale as clubs, implementation of the principle of competitive neutrality would necessitate that all NFPs disengage from any competitive commercial activity. Clearly this would be to the detriment of the NFP sector and the Australian community.

It is important to note that the Australian Taxation Office (ATO) argued a line very similar to competitive neutrality against Word Investments, but lost in the High Court[1]. The Court found that it is entirely appropriate for NFPs to raise income through commercial activity (in this case, a funeral home) – even if the income is raised through a purely commercial operation that is separate to the charitable arm. The Federal Court's Justice Sundberg commented about the Word case[2]:

> With the decline of the welfare state, charitable organisations are expected to do more with the same resources… Hence many charitable organisations have established business ventures to generate the income necessary to support their activities. There may appear to be a vast difference between selling lamingtons at a church fête and selling funeral services, but where the object of raising the funds is the same, I can see no reason to draw a legal distinction between the two.

Clubs cannot fulfil their sporting and social purposes through bake sales. Quality infrastructure, maintenance and other costs required by the sporting community are too high. Our not-for-profit purpose makes us believe, on the basis of advice from Senior Counsel, that the Word case has application to clubs and other NFPs. Clubs need to be professional operations capable of generating significant revenue. Although clubs generate something like 20 percent of all NFP income (other than through Government grants), the demand for contributions from clubs, by various charities and sporting groups, exceeds the capacity to meet and is constantly growing.

ClubsAustralia submits that clubs and all other NFPs raising funds through commercial activity to fulfil their purpose, be allowed to do so within the current taxation framework.

[1] *Commissioner of Taxation of the Commonwealth of Australia v Word Investments Limited* [2008] HCA 55
[2] *Commissioner of Taxation v Word Investments Ltd* [2006] FCA 1414 (3 November 2006)