SUBMISSION TO THE HENRY REVIEW OF AUSTRALIA'S FUTURE TAX SYSTEM

Clubs form an essential part of the social fabric of Australian life. As not-for-profit organisations, clubs have utilised their revenue to build sporting and community infrastructure, support charities and provide a comfortable and affordable place to meet, eat, drink and enjoy entertainment. Governments of all persuasions have generally regarded registered clubs as deserving of differential treatment in terms of tax, due to the many benefits that flow to the community rather than to individuals or corporations. The social contribution of clubs is significant and growing, being measured by the NSW Independent Pricing and Regulatory Tribunal (IPART) at $811 million per year and conservatively estimated as being at least $1.2 billion if extrapolated nationally. This is in addition to clubs' substantial contribution to economic activity and employment.

ClubsAustralia understand the Henry Review will provide a comprehensive analysis of Australia's tax system. To that end, we believe it is vital that in considering tax arrangements as they apply to not-for-profit clubs that the Review recognise the Club Movement's social and economic contribution. Unless the significant and growing contribution made by clubs is taken into account, it is not possible to appreciate how much value the Government and community realise through the tax treatment of clubs. Clubs pay very large amounts of State tax, especially on the operation of gaming. On the basis of surveys conducted by State club associations, ClubsAustralia estimates total annual tax paid by clubs is around $2 billion.

Through successful business practices over many years, the Club Movement has been able to provide services and infrastructure to communities that governments and the private sector do not. Numerous charities have come to rely upon clubs. From sporting fields and swimming pools to aged care and childcare facilities, community transport and social interaction, clubs have helped grow and sustain communities. Clubs are unique to Australia and there is no similar model anywhere in the world. Without current tax arrangements for eligible clubs, which include the principle of mutuality and sporting club tax exemptions, this would not have been possible and clubs as we know them would not exist.

The Review of the Registered Clubs Industry in NSW, conducted by IPART in 2008, provides additional, independent and authoritative analysis that justifies the beneficial tax and regulatory arrangements clubs enjoy.

About Clubs

Registered and licensed clubs are not-for-profit community-based organisations, formed and sustained by people with common interests to pursue those interests. They are immensely popular social and entertainment venues. Surveys indicate there is a total of 11.8 million club memberships held across Australia – averaging just above one membership for every two Australians.

Club membership is notable in terms of its size and diversity, both demographically and geographically. Club membership is fundamental to the mutual nature of clubs and a foundation of the industry's relevance and capacity to deliver services and facilities to the community.

Research conducted in NSW by ClubsConsulting reflects club members' support for the not-for-profit, mutual status of clubs and the purpose for which they are formed and maintained. The research found that:

- 63 per cent of people are aware that clubs are not-for-profit organisations;
- 81 per cent of people are aware that clubs contribute revenue to local community projects; and
- 41 per cent of people are aware that clubs make community contributions in excess of statutory requirements.

There are over 4,000 clubs in Australia. The Australian Bureau of Statistics Report *8687.0 - Clubs, Pubs, Taverns and Bars, Australia 2004/05* records there being 2,116 hospitality clubs operating in Australia at that time. However, it is noted that around 2,000 clubs did not class themselves as 'hospitality clubs' so were not included in the report. A proportion of these are included in the ABS Report *8686.0 (2004-05) Sports and Physical Recreation Services, Australia 2004-05*, although that report also covers non-club sporting organisations, so it is difficult to draw meaningful figures. The *Clubs, Pubs, Taverns and Bars* report is also already four years old. Therefore, while the statistics are instructive at a national level, it must be remembered that the data set is incomplete. ClubsAustralia believes better information about clubs will be available from the Productivity Commission's current inquiry into Not-For-Profit Organisations, due to conclude in December 2009.

According to the ABS, the total industry value added by clubs was $4,086.1 million, which was the equivalent of 0.5 per cent of Australia's GDP for 2004-05. ClubsAustralia estimates national club revenue to be approximately $7.5 billion per year.

Mutuality

The principle of mutuality is not specifically contemplated under the Income Tax Assessment Act, but rather has arisen out of common law. The principles behind mutuality are still as relevant in 2009 as they were in 1918 when set out in *The Bohemians Club v The Acting FCT (1918) 24 CLR 334*.

The current taxation treatment of clubs is governed principally by the 'Guidelines for registered and licensed clubs' issued by the Australian Taxation Office in 1992. The Guidelines are based on the premise that clubs are associations formed for the mutual benefit of members rather than as profit-making commercial enterprises.

The Guidelines explain mutuality in the following terms:

> *The principle of mutuality provides that where a number of persons contribute to a common fund created and controlled by them for a common purpose, any surplus arising from the use of that fund for the common purpose is not income. This principle, of course, does not extend to include income that is derived from sources outside the group. Where the principle aim of a club is to provide and improve facilities to its members, the principle of mutuality will apply to all transactions between that club and its members.*

In brief, a mutual entity like a club cannot derive any gain, and thus any income, from dealings with itself. The ATO's Guidelines say that the principle of mutuality will apply where a club has the following general attributes:

- Its rules prohibit the distribution of surplus funds to members;
- Upon dissolution, its rules require surplus funds to be distributed to another club with similar interests and activities;

- Club operations fall within the ambit of State/Federal laws governing clubs; and
- The club is a member of a recognised Club Association.

The ATO's Guidelines require clubs to keep records of the number of members and non-members attending the club throughout the year and, in some cases, surveys need to be taken to ascertain the percentage of members who attend. As a group, not individually, club members are the owners of club assets but, importantly, they do not have property rights to their share in the common funds that support the club's activities. They cannot sell their share, and when they cease to be members they lose their right to participate and they receive no financial compensation in return.

In contrast, a non-mutual trading corporation is established and operated for the purpose of making profits for its shareholders. Such corporations trade for commercial gain and have no obligation to support community activities or contribute to local social services or infrastructure. Annual profits may be distributed to shareholders, who are free to dispose of their shares for value on the open market. Most corporations are not restricted to the principal purposes of providing 'accommodation' to members and assisting the community, but may trade at large with the public for profit. The public is aware that any profits from trading may be distributed to the corporation's shareholders. On winding up, excess assets of a non-mutual trading corporation are distributed to its shareholders.

In the case of clubs, any trading surpluses are held and applied for the benefit of the membership as a whole and, by extension, the surrounding community. In practice, surpluses are channelled into facilities to promote the club's purpose or to support its chosen cause or community services. These characteristics of clubs distinguish them from normal commercial trading entities.

Effectively, clubs are subject to tax on income from sources wholly outside the club, such as investment income, or where a club simply leases space or a facility to an operator. Plus they are subject to an appropriate proportion of profits from general trading activities in which both members and non-members take part – for example, gaming machine, bar and catering. No tax is payable in respect of receipts generated solely from members, such as subscriptions and purchases of membership badges.

The principle of mutuality was compromised in the decision of the Federal Court of Australia in *Coleambally Irrigation Mutual Co-operative Ltd v Commissioner of Taxation* [2004] FCAFC 250 (the Coleambally Case). Contrary to long established practice endorsed in the ATO's Guidelines, the Court decided in that case that the principle of mutuality did not apply where the rules of an organisation prevented members from sharing in any surplus if the organisation was wound up. The ramifications of this case would have had dramatic effects on clubs had it not been limited through legislation.

Government's strong support for maintaining mutuality was displayed when the effects of the Coleambally case were resolved by an amendment of the Income Tax Assessment Act 1997, assented to in March 2006. However ClubsAustralia remains concerned that another court might seek to limit or overturn the principle of mutuality in the future. As a result, ClubsAustralia is seeking long term certainty for our members through codification of the principle in legislation. Codification was previously recommended by the Ralph Review of Taxation in 1998 which found that the current common law exclusion should "be given explicit effect in the tax law". ClubsAustralia has raised this matter with the Australian Government and would be prepared to provide further detail on request.

Consequences of Increased Taxation

Most clubs would respond to a significant tax increase by adjusting their outgoings, such as donations and capital expenditure, and increasing the prices of non-gaming products, such as food and drink. The real negative impact would be on all club members and the broader community. In some cases, as has been seen in NSW since the introduction of higher gaming machine tax rates, clubs cannot absorb the additional tax and are forced to close.

The 2007 Socio-Economic Impact Study of NSW clubs by the Allen Consulting Group asked clubs how they would respond to reductions in net revenue of $10,000 to $1 million. Clubs' responses suggested that the smallest clubs would seek to compensate for the effect by increasing membership fees (23 per cent) and retail prices (17 per cent) or reduce capital expenditure (22 per cent).

Similarly, the largest clubs identified increases in retail prices (around 22 per cent), reduced community support (around 21 per cent) and reduced capital expenditure (around 20 per cent) to fund a reduction in revenue of between $10,000 and $100,000. If faced with a $1 million reduction in revenue, the largest clubs identified that they would reduce capital expenditure (31 per cent) and community support (20 per cent) to fund a shortfall.

This finding is instructive and relevant to all jurisdictions, especially in the context of IPART's recommendation that clubs be fully consulted by the State Government in advance of future changes in club-related policy.

It is important to be aware that clubs in all jurisdictions are increasingly being forced to close or amalgamate. The NSW club industry has contracted by up to 20%, in terms of club numbers, in the last ten years. This can be attributed to a range of factors, from higher taxation to indoor smoking bans and other Government policies as well as increased competition, falling participation in games like bowls and other factors. ClubsAustralia strongly believes that in these difficult economic times it would be highly deleterious to club viability, as well as the communities and jobs they support, to increase taxation on clubs.

Income Tax (Sporting Club) Exemption

Under the *Income Tax Assessment Act 1997* section 50-45, eligible clubs can be exempt from income tax on the basis of having a main purpose of encouraging sport. ClubsAustralia estimates that up to two-thirds of clubs qualify for this exemption and believes this tax exemption is of the utmost importance to those clubs and the sports they support.

Eligible sporting clubs generally provide the majority of their surplus revenue from trading, after operational and maintenance expenses, to sporting purposes in compliance with the constitution of the club. The club will commonly be named after a sporting team or region, so all members and visitors know that the club's revenue supports a specific purpose. Typical examples include bowling clubs, golf clubs, regional sports clubs and football clubs. The Tax Office has stringent eligibility tests to qualify for the sporting club tax exemption and there are numerous legal cases that have addressed the criterion for qualification. However over many years Governments of all persuasions have clearly recognised the merit in assisting clubs to support sport.

The incentive provided through the federal tax arrangement has overwhelmingly achieved its goal of building and maintaining sporting infrastructure and encouraging community participation. In the opinion of ClubsAustralia, this has contributed significantly to the success Australia has enjoyed worldwide in sporting competitions. ClubsAustralia believes there is opportunity for the Federal Government to play a greater role in working with clubs to ensure the level of sporting infrastructure and sporting participation is sustained.

GST

State taxes on gaming machine revenue were adjusted to accommodate GST in a manner that achieved revenue neutrality for the States, and this largely remains the case today. However, the States have benefited from the additional revenue that has flowed through from GST monies. So the introduction of GST changed only the way the States and Territories receive tax from clubs, not the amount they receive. Effectively, the Commonwealth collects 9.09 per cent of club gaming machine revenue and passes it back to the States and Territories. So in the top club tax bracket in NSW, for example, the State Government receives gaming machine tax of 29.4 per cent plus (indirectly to the community) CDSE of 1.5 per cent plus (indirectly from the Commonwealth) 9.09 per cent, representing GST on club gaming revenue. This totals 39.99 per cent in the top tax bracket.

Fringe Benefits Tax Generally

Peculiar situations arise for clubs that calculate their tax on the basis of mutuality. Where an employer is taxable, but some of its receipts are treated as non-assessable because of the operation of the mutuality principle, there is, unfortunately no special treatment that arises for FBT purposes.

The income tax deduction allowed for FBT paid is not a statutory deduction, so the full amount is not claimable, in the same manner that the full amount expended on employees' superannuation contributions is deductible.

Thus a club or association using the "Waratah's formula" or another acceptable method to determine its taxable income would be entitled to claim only a portion of the FBT paid in respect of staff benefits as an income tax deduction.

FBT and Tax-Exempt Body Entertainment Fringe Benefits

Division 10 of the FBT Assessment Act applies to "tax-exempt" bodies, although the limitations in that division can also apply to mutual entities. Significantly, "non-deductible exempt entertainment expenditure" is defined in section 136(1) as follows:

> "non-deductible exempt entertainment expenditure" means non-deductible entertainment expenditure to the extent to which it is not incurred in producing assessable income.

As mutual clubs and associations will have entertainment expenditure which, through the application of the mutuality principle, will not be deductible against assessable income, they will have "non-deductible exempt entertainment expenditure". Consequently, despite the misleading reference to "tax-exempt", entertainment expenditure incurred by mutual clubs and associations is classified as "tax-exempt body entertainment fringe benefits" for FBT purposes.

The implications of this include:

1. Exempt minor benefits under section 58P of the FBT Assessment Act are more limited. The minor benefits exemption for these entities is available only where:
    - the provision of the entertainment is incidental to the provision of entertainment to outsiders and does not consist of a meal, other than light refreshments (an example might be an event run mainly for clients and suppliers at the races where finger food and some alcohol is provided); or

- a function is held on business premises solely as a means of recognising the special achievements of your employee in a matter relating to the employment of your employee.

2. The exemption for certain property benefits under section 41 of the FBT Assessment Act as in-house property fringe benefits is not available.

We submit that any review of the Australian tax system should address these anomalies and provide for the exemptions allowable to other organisations also apply to mutual organisations in the same way. We consider this should be addressed as part of the codification of the mutuality principle.

IPART Review of the NSW Clubs Industry

In June 2008, the NSW Independent Pricing and Regulatory Tribunal (IPART) completed a comprehensive Review of the Registered Clubs Industry in NSW. The review was very supportive of the clubs industry, in that it recognised the NSW Government's intention to facilitate a sustainable industry and also acknowledged the valuable social and economic contribution made by registered clubs to the state's social infrastructure and services. IPART noted that clubs do attract some favourable treatment from the NSW Government (for example, lower rates of taxation on gaming machine profits compared to hotels).

Australia is unique in the world in its level of public access to recreation, entertainment, sporting and other community facilities. This is in part the reason why clubs were granted the privilege to sell liquor and provide gaming facilities - so the average person in suburban and regional Australia could enjoy facilities usually reserved for the privileged in the community. The role clubs play in promoting social equity is an important one.

In practical terms, without money there can be no pursuit of a club purpose. IPART found that clubs also provide considerable intangible social benefits that are impossible to quantify but should not be ignored. These include the sense of belonging that some club members feel and the greater social cohesion a community might experience as a result of having a club where people can meet and mix, preventative health benefits from participation in organised sport and longevity for aged people through mental and social interaction.

Non-professional sport plays a vital role in the community, with around 95% of clubs providing a means for individuals to become more physically active, and to establish social networks within their community. The benefits of participation in sport are diverse and include those relating directly to the participant, as well as to the broader community, including:

- Physical and psychological benefits for individuals by improving their health status through exercise and increased social interaction;
- Community benefits from reduced healthcare costs due to the improved health status of participants;
- Enhancement of community identity and promotion of community integration along socio-economic and ethnic lines; and
- Deterrence of antisocial behaviour through improved self esteem.

On balance, IPART concluded that the club industry's social contribution is positive. On this basis, it considered that it is appropriate that the NSW Government provide support to the industry, to help ensure that it remains financially viable so that clubs can continue to contribute to positive social outcomes in the state. ClubsAustralia commends this approach to the Henry Review.

Harmonisation of Tax Arrangements

ClubsAustralia does not believe there has been significant harmonisation in gambling taxation arrangements. For example, the recent decision by the Victorian Government on club and hotel gaming machine tax from 2012 is completely different to any other jurisdiction.

ClubsAustralia believes that where the States and Territories are the regulators, as they are in relation to clubs and gaming, they should also decide the tax regime.

However, there is a role for the Australian Government in relation to internet-based gambling. Currently, for example, an undesirable situation exists where Tasmania and the NT derive tax from customers in other Australian jurisdictions via internet gambling sites located in those jurisdictions. While the tax paid is minimal by comparison with land-based gaming venues and there are very few jobs involved, the broader principle that money spent in a State should be taxed by either that State or the Commonwealth is being breached. The Commonwealth regulates this space through the *Interactive Gambling Act 2001*. Given the pan-jurisdictional nature of web-based gambling, ClubsAustralia believes it is appropriate for the Commonwealth to also play a role in taxing these businesses.

Alcohol Excise

The alcohol excise regime in Australia has evolved over many years to reflect a range of competing interests and factors. While a flat rate of alcohol excise would provide simplicity in regard to the assessment and collection of alcohol tax, it would deny the good public policy reasons for variations in taxation. These include the value of jobs in manufacturing and retailing, variations in cost of manufacturing, consumption prevalence among youth, binge and at risk drinking groups, competing interests between on and off premise consumption and the elasticity of demand.

ClubsAustralia is of the view that drinking choices are influenced by significant increases in tax and other price shifts. There are a range of other unintended consequences which can arise from tax changes. In particular, there is strong evidence to show that when the price of consumption on premise becomes high relative to the price of packaged alcohol for consumption off premise, consumers will shift to packaged alcohol products and drink at home in an uncontrolled environment.

The average sale price of a 285ml tap beer is $3.50, while for packaged beer of the same size it is $1.11. This is principally because on premise service requires more staff, which forces up the margin for sale and has a corresponding increase in the GST applicable. The total federal tax paid on the tap beer is 63 cents while the tax on the same sized packaged beer on average is only 54 cents. So while the excise rate for draught beer is lower than for packaged, the GST rate on draught beer dramatically outweighs the benefit from the discounted excise rate. If the discounted excise rate for draught beer were removed it would therefore further increase the cost per unit for consumption on premise and encourage consumption at home, costing jobs.

There are many benefits to people drinking in clubs as opposed to at home, such as social interaction, professional supervision of consumption and flow-on expenditure such as food and gaming which flows through as club expenditure on community infrastructure and service provision. Further, the community benefits from consumption in clubs through the redistribution of surplus revenue. ClubsAustralia therefore strongly opposes any change to the excise rate for draught beer, particularly any change which removes the relative discount to packaged beer.