

The Council of Community Clubs of Australia and New Zealand

Inquiry into Australia's Gambling Industries

Public Submission - 2

The Taxation of Clubs

15 January 1999

Comprising
.. The Registered Clubs Association of New South Wales .. The Licensed Clubs Association of the ACT ..
.. Licensed Clubs Association of Victoria Inc. .. Clubs Queensland .. Licensed Clubs' Association of South Australia ..
.. The Association of Licensed Clubs of Western Australia Inc. ..
.. The Registered Clubs of Tasmania Co-Operative Society Limited .. New Zealand Chartered Clubs (Incorporated)

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Submission to the Productivity Commission's Inquiry into Australia's Gambling Industries

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Australia's Gambling Industries**

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1.0 Executive Summary

Clubs prime role is to provide recreational, cultural and social outlets for their members through the delivery of services and facilities and to support the broader Australian community. However divergent their focus, this overall objective of registered and licensed clubs to support the community, either through membership or more broadly, is effectively universal.

Club membership is estimated at nine million. This figure represents approximately 64 percent of the adult Australian population. In addition, not included in this statistic is the large number of people who patronise clubs either as guests of members or temporary members/visitors.

The community, through the club structure, has responded to its own requirements for a wide range of cultural, social and recreational services and facilities delivered at an affordable price. Both the number of clubs and club patronage have expanded primarily because clubs operate for the benefit of the community without the incentive to create financial gain for individuals in the style of privately operated venues.

The Constitutions of clubs have a number of common elements. They define the clubs' objects, restrict the use of income and property to promotion of those objects, absolutely prohibit the distribution of money to members, identify an obligation to treat all members equally, and, in addition to legislative requirements, regulate membership. A club's Constitution sets it apart from all other venues that offer gaming and wagering.

The core elements for a club's existence as outlined above, are at the root of the Club Movement's commitment to community owned gaming.

In relation to the tax treatment of clubs, all clubs are regarded as companies for income tax purposes. As such, their income is subject to tax at the prevailing tax rate (currently 36 %) unless:

- ◆ the specific provisions of the Income Tax Assessment Act 1997 exempt a club's income from tax, or
- ◆ the common law applies to exclude certain receipts from a club's assessable income.

This latter point, known as the principle of mutuality, represents an important factor which has assisted the Club Movement to deliver the services and facilities required by members and the broader community.

All clubs should continue to receive the benefit of mutuality while ever they are non profit mutual organisations. Members' contributions are applied for the benefit of those members in accordance with their wishes. As such, these contributions are not income and are not subject to Federal taxation. Expenses associated with members' activities are similarly not deductible.

Differential gaming machine duty rates reflect the basic difference in the underlying purposes of community owned and privately owned gaming in Australia. State and Territory Governments have recognised that higher rates are appropriate for private operators as:

- ◆ Clubs recycle their gaming revenue back to the community, either through the provision of services or facilities to patrons, or through a range of cash and non cash community support mechanisms.
- ◆ Private operators of gaming throughout Australia conduct their businesses on the basis of maximising shareholder/proprietor wealth, ie, creating economic benefit for specific individuals.

Clubs are not critical of private operators for conducting their operations with a primary focus on wealth generation for individuals – it is a legitimate commercial rationale for investment. This fundamental difference is however the reason why clubs should receive Government taxation and gaming concessions, so that there is a tangible link between the concessions, and the consequent benefit of those concessions, flowing directly back to the community.

2.0 Terms of Reference of the Inquiry

In August 1998, the Federal Treasurer, Peter Costello, under Parts 2 and 3 of the Productivity Commission Act 1998, referred Australia's gambling industries for inquiry and the provision of a report.

The Inquiry gave recognition to the *"need for a better understanding of the performance of the gambling industries and their economic and social impacts across Australia, including their impact on the retail, tourism and entertainment industries and on Commonwealth and State/Territory Budgets."*¹

The Inquiry's Terms of Reference were scoped as follows:

"3. *In particular, the Commission should examine and report on:*

- (a) *the nature and definition of gambling and the range of activities incorporated within this definition;*
- (b) *the participation profile of gambling;*
- (c) *the economic impacts of the gambling industries, including industry size, growth, employment, organisation and interrelationships with other industries such as tourism, leisure, other entertainment and retailing;*
- (d) *the social impacts of the gambling industries, the incidence of gambling abuse, the cost and nature of welfare support services of government and non-government organisations necessary to address it, the redistributive effects of gambling and the effects of gambling on community development and the provision of other services;*
- (e) *the effects of the regulatory structures – including licensing arrangements, entry and advertising restrictions, application of the mutuality principle and differing taxation arrangements – governing the gambling industries, including the implications of differing approaches for industry development and consumers;*
- (f) *the implications of new technologies (such as the Internet), including the effect on traditional government controls on the gambling industries;*
- (g) *the impact of gambling on Commonwealth, State and Territory Budgets; and*
- (h) *the adequacy of ABS statistics involving gambling."*²

¹ Treasurer's Press Release No.84, Canberra, 25/08/98

² Ibid.

3.0 Submission Approach

To assist the Productivity Commission ("Commission") in its inquiry, the Council of Community Clubs of Australia and New Zealand ("CCCANZ") has provided the following reports:

- ◆ Submission to the Productivity Commission - Inquiry into Australia's Gambling Industries: Public Submission, dated 16 November 1998.
- ◆ Submission to the Productivity Commission - Inquiry into Australia's Gambling Industries: Confidential Annexure, dated 16 November 1998.
- ◆ Submission to The Independent Pricing and Regulatory Tribunal of New South Wales - Gaming Inquiry - Public Submission of 24 August 1998.
- ◆ Submission to The Independent Pricing and Regulatory Tribunal of New South Wales - Gaming Inquiry - Confidential Annexure of 24 August 1998.

This submission focuses on Item 3 (e) of the Commission's terms of reference, and in particular, the effect of regulatory structures - the application of the mutuality principle and differing taxation arrangements - governing the club industry.

This submission seeks to translate the technical features of the Federal and State systems of club taxation, detailed in the CCCANZ's submission dated 16 November 1998 (including the confidential annexure thereto), into a demonstration of the application of these features by clubs.

This approach will provide the Commission with a greater insight into the operation of clubs as they fulfil a prime role in the provision of recreational, cultural and social outlets for their members and support through the delivery of services, facilities and funding for the broader Australian community.

Research Material

The views expressed in this submission are sustained by research and survey analysis undertaken on the club industry during the past 18 months, including:

- ◆ Pannell Kerr Forster ("PKF") - Report to the Joint Working Party ³ ("Working Party")
PKF's findings were based on survey data collected from 322 New South Wales clubs during late 1997 (annexure 2).
- ◆ Pannell Kerr Forster - a report to the Registered Clubs Association of New South Wales ("RCA"), December 1998.
Commissioned by the RCA, PKF revisited their 1997 survey analysis results to provide further insight into the form, and reporting of community support provided by NSW clubs and the operating results of clubs.
- ◆ KPMG Audit Division - Mutuality Principle, December 1998
Commissioned by the RCA, KPMG undertook a detailed analysis of 9 "top twenty"⁴ club clients to provide a view on how the larger clubs within the industry apply the principle of mutuality to their operations.
- ◆ KPMG Hospitality Management Services - Impact of the Increase in Gaming Taxation, January 1998
Commissioned by the RCA, the report analysed the impact of the revised gaming tax structure (effective 01.02.98) on NSW clubs. The analysis was based on a survey of 400 clubs⁵ likely to be affected by the change in gaming machine taxes (annexure 3).
- ◆ Ernst & Young - Tax Consultative Taskforce Submission on GST and Tax Reform
Commissioned by the CCCANZ, this report examined the implications for the club industry of the imposition of a GST under various scenarios, using a case study approach (annexure 4).

³ In mid 1997, the Government in conjunction with the RCA, established a Working Party comprising representatives of the Premiers Private Office, Premiers Department, Cabinet Office, Office of the Treasurer, Treasury, Office of the Minister for Gaming and Racing and the Department of Gaming and Racing, together with representatives of the club industry and the relevant industry unions.

⁴ "top twenty" refers to clubs recorded by the NSW Department of Gaming and Racing as the first twenty clubs listed in its "Statewide Top 200 Clubs by Gaming Machine Profit - Year ended 30 May 1997", reported in its Gaming Analysis 1996-97.

⁵ Due to time constraints, data on 374 clubs was analysed in the report.

- ◆ **Working Party Survey**
As part of the Working Party process, the views of Government Instrumentalities throughout New South Wales, on the contribution of clubs to their local community, were sought. The responses were considered by the Working Party and also by PKF and were incorporated in each body's final report (annexure 9).
- ◆ **RCA Survey**
During December 1998, the RCA circulated a survey to 34 NSW clubs drawn from the "top twenty" clubs together with clubs that had been the subject of recent Australian Hotels Association allegations. Clubs were requested to provide additional insight into the impact of mutuality principles on their club's operations.

Confidentiality

Much of the information included in this submission was provided by clubs to the consultants on a "commercial in confidence" basis, and has not been provided to the CCCANZ or RCA in a disaggregated form. Accordingly, this submission and the annexures thereto, only include references to averages, aggregates etc and club secretary managers' views in a manner that does not breach the confidentiality commitments made to the clubs.

4.0 Clubs as Mutual Entities

"Mutual" is defined in the Macquarie Dictionary⁶ as "possessed, experienced, performed, etc., by each of two or more with respect to the other or others...having the same relation each towards the other or others...pertaining to each of two or more, or common...".

By philosophy and by legislation, registered and licensed clubs are mutual organisations. Clubs are groups of people sharing a common interest who have bonded together to promote or pursue that interest. Clubs are non-profit organisations that must, as a matter of law, treat all members equally⁷. This basic feature, combined with the Club Movement's commitment to community support is at the root of the industry's unequivocal advocacy of community owned gaming.

Clubs can be considered commercial enterprises in the sense they have an underlying goal of continuing the provision of services and facilities to their members in accordance with their objects. However the restrictions embodied in their Constitutions and imposed by legislation oblige clubs to direct their revenues into the provision of services and facilities for the benefit of members and that component of the community that extends beyond the member base (see annexure 7).

⁶ The Macquarie Concise Dictionary, 1988, The Macquarie Library Pty Limited, NSW.

⁷ Example: Registered Clubs Act 1976 Sec 10(1)(i).

5.0 Key Regulatory Principles and Practice

5.1 Federal Income Taxation

All clubs are regarded as companies for income tax purposes. As such, their income is subject to tax at the prevailing tax rate (currently 36%) unless:

- ◆ the specific provisions of the Income Tax Assessment Act 1997 ("Act") exempt a club's income from tax, or
- ◆ the common law applies to exclude certain receipts from a club's assessable income.

The background to, and effect of, these exemptions and exclusions, including the application of the Waratah's Formula have been dealt with at length in the confidential annexure to the CCCANZ's submission dated 16 November 1998.

Key aspects of these exemptions and exclusions are as follows⁸:

- ◆ Clubs which demonstrate that they satisfy the requirements of Taxation Ruling TR97/22 "Income Tax: Exempt Sporting Clubs" will be exempt from tax under section 50-45 of the Act. Formal application for exemption setting out the club's character, purpose and activities; the nature and sources of its income etc is required to be lodged with the Commissioner of Taxation ("Commissioner") for approval. The fundamental test, although there are others, is whether such activities were carried out with the main or dominant purpose of encouraging or promoting a game or sport. A club must satisfy this test each year.
- ◆ The common law "principle of mutuality" recognises that a person's income consists only of moneys derived from external sources. As such, members' subscriptions and amounts received from members for particular services provided by a club are excluded from the assessable income of that club.
- ◆ Income from external sources such as bank interest, rental of property etc as well as income derived from non-members visiting the club (including members' guests and temporary members/visitors) and using its facilities is fully assessable. Expenses associated with the generation of non-member receipts are deductible.

⁸ 1998 Australian Master tax Guide, CCH Australia: 4-000 - 4-050, 7-000 - 7-010.

The Commissioner accepts the use of the "Waratah's Formula" or alternative methods that produce a reasonable and accurate measure of member and non-member income as a basis for assessing a club's liability to taxation. The Taxation Tribunals (TBRD Case T55) have tested this approach and its application is scrutinised as part of the normal audit program of the Australian Taxation Office ("ATO").

Tax rates applicable to non-profit companies, including incorporated and unincorporated clubs are as follows:

On taxable income up to \$416	Nil
On the excess over \$416 up to \$1,204	55%
Where taxable income exceeds \$1,204 the normal corporate rate applies from the first dollar of taxable income	36%

5.1.1 Sport and Community Service Exemptions

The application of the exemption available to clubs that satisfies the requirements of Division 50 of the Act has been dealt with at length in the confidential annexure to CCCANZ's submission dated 16 November 1998.

Further information can be provided at the request of the Commission.

5.1.2 Mutuality as a Principle of Taxation Law and Why it Applies to Clubs

The basic premise underlying the principle of mutuality is that an amount received from oneself is not income, and is not subject to tax, because the person has not made an economic gain from an external source. Likewise where a number of people form a group, such as a club, for a common purpose, and pool their funds for that purpose, those funds are not income of the group. The funds originate from the group and they control how the monies will be spent.

This principle of mutuality applies not just to clubs, but to thousands of mutual organisations engaged in a wide variety of activities.

The decision of the High Court of Australia in the 1918 case *The Bohemians Club v The Acting Federal Commissioner of Taxation* confirmed that the surplus of subscriptions and contributions from club members over the expenditure of the club did not constitute assessable income.

*“A man is not the source of his own income...A man's income consists of moneys derived from sources outside of himself. Contributions made by a person for expenditure in his business or otherwise for his own benefit cannot be regarded as his income..”*⁹

This decision remains the precedent for isolating that component of a club's receipts that will not be subject to tax. Members' receipts are not exempt income, rather they are excluded from the definition of income for tax purposes.

A club's Constitution, defining its objects and restricting the use of its income and property to promotion of those objects, absolute prohibition on the distribution of surpluses to members, and its rules (including those deemed through legislation) regulating membership set clubs apart from all other venues offering gaming and wagering. Differences in objects arise as a result of the variations in the underlying focus of individual clubs.

Clubs reflect the community's wide and diverse range of recreational, social and cultural interests which can be broadly characterised as sporting, social/community, workers, ethnic, religious and returned servicemen clubs (refer annexure 6). However divergent their focus, the basic aims of providing services and facilities to members, as well as engendering community support are effectively universal.

A typical club's Constitution, together with key legislative requirements, are attached as annexure 7.

5.1.3 How Mutuality Works

Determining a club's liability to tax requires identification of the source of a club's receipts and expenditure.

Receipts that can be directly associated with a club's members are excluded from assessable income on the basis of mutuality. Members' subscriptions are the most obvious example of excluded receipts. Other receipts, such as payments for services and use of facilities at "members-only" clubs, rental income for holiday accommodation available to members typically under a ballot system are similarly clearly identifiable as mutual, and not subject to tax.

⁹ The Bohemians Club v The Acting Federal Commissioner of Taxation 1918 24 CLR 334-339.

5.1.4 The Consequences of Mutuality – Taxation Considerations

As the principle of mutuality excludes from tax, receipts attributable to members, the primary consequence of mutuality is the need to separate member receipts and non-member receipts.

Receipts from non-members including temporary membership fees and payments to the club for the use of its services and facilities as well as interest on moneys invested, dividends on shares, rental on commercial real estate and non-member accommodation etc are subject to tax. Also subject to tax are capital gains arising from property transactions etc.

It is therefore necessary for clubs, other than those subject to an exemption from taxation pursuant to Division 50 of the Act, to apportion both their income and expenses between those amounts attributable to members and amounts attributable to non-members.

However apportionment may be difficult, if not impossible, in some instances, particularly for receipts such as gaming machine proceeds, bar and dining room sales and the like.

As a matter of practical efficacy, the Commissioner has adopted a formula¹⁰ as a rule of thumb to determine the percentage of receipts which is reasonably attributable to non-members, and therefore subject to tax. The use of “rules of thumb” is not uncommon in the determination of taxable income. Examples of their application are provided in the confidential annexure to CCCANZ's submission dated 16 November 1998.

Clubs are not obliged to apply the Waratah formula, providing they achieve by some alternative means, a reasonable and accurate measurement of a club's non-member income. However, Taxation Tribunals have accepted the formula approach as reasonable in the absence of evidence from the club to show that the method is unjustified or that some other method is more suitable¹¹.

Just as a club's receipts are required to be analysed to determine their exposure to taxation, so to are a club's expenses. The principles outlined above are also applied to club's outgoings to ascertain the portion properly deductible against assessable income.

¹⁰ “Waratahs” Rugby Union Football Club Ltd v FC of T 79 A TC 4337, guidelines for the application of the Waratah's formula issued by the ATO in 1993.

¹¹ 18 TBRD Case T55.

5.1.5 The Consequences of Mutuality – Commercial Considerations

Surveys undertaken during the past 18 months referred to in section 3 above demonstrate the significant benefit derived by many clubs through the application of the principle of mutuality. Annexure 1 summarises key findings of these surveys.

Clubs, like any other provider of facilities and services, undertake business planning on the basis of their expectations of the future, including their knowledge of the environment in which they operate. Mutuality is embedded in the common law, and the principles proclaimed in the Bohemians and Waratahs cases referred to above have retained legislative and practical support in their application.

With this knowledge, clubs have committed to expenditure programs that will permit them to continue to meet the needs of their members, in accordance with the clubs specified objectives. Clubs, particularly in NSW, have been subjected to a range of inquiries and variations in duty structures, often emanating from effective lobbying by pressure groups opposed to the success of the Club Movement as it continues to meet the needs of the community. While past inquiries have generally¹² acknowledged the legal soundness of clubs operations (refer annexure 4 & 5), the instability generated by the onslaught of investigations causes difficulties for many clubs, particularly those relying on the support of financial institutions or other credit relationships.

¹² Hutchinson Report of October 1997, called for a review of the commercial activities of licensed clubs.

5.1.6 Setting Parameters for the Application of Mutuality

Research and surveys undertaken during the past 18 months have established that clubs apply the principles of the common law, augmented by guidelines issued by the ATO to identify and exclude from assessable income, revenue streams that are rightly allocated to members. The summary of key findings at annexure 1 identifies that clubs:

- ◆ respond to the needs of their members by providing a range of services and facilities consistent with the club's objects as specified in its Constitution.
- ◆ will augment the facilities and services available at a point in time, at the behest of the members, where there is a recognised but unfulfilled need in the local community that cannot be met through alternative private or Government funded means.

There is no question of clubs seeking to achieve an inappropriate advantage through the application of mutuality. Business planning that involves the commitment by a club to a particular project or activity is undertaken with knowledge of the law. That is:

- ◆ Mutual receipts are excluded from the definition of income for the purposes of income tax.
- ◆ Clubs are subject to tax at the normal corporate rate of 36% on non-mutual income.
- ◆ The 'mutuality percentage' that is determined on a club by club basis and reflects the utilisation mix between members and non-members is applied to that component of a club's revenue which cannot be readily distinguished as either member or non-member sourced.
- ◆ Clubs are non-profit organisations. All members are to be treated equally. Revenue derived through the operation of the club is applied to the benefit of club members and to that part of the community extending beyond the club membership, in accordance with the particular club's objectives.

5.2 State Regulation and Taxation

5.2.1 Legalisation of Gaming Machines in Australia

Gaming machines were legalised in New South Wales in 1956.

In submitting the Gaming and Betting (Poker Machines) Bill for its second reading to the New South Wales Legislative Council in August 1956, the Hon. R.R. Downing noted that

"Poker or fruit machines seem to have made their appearance in non-proprietary clubs in the early 1920's; and despite the Gaming and Betting Act, successive governments have taken an attitude of "no objection" to their use, broadly on the grounds that they were not available to the general public, were inaccessible to children and the profits were not going into the pockets of individuals but were being applied to club amenities and improvements. In short, they had become a basic feature in the economy of many worthy organisations such as bowling clubs, golf clubs and return soldiers' clubs...the Government has examined the whole matter exhaustively and has now decided to legalise and control the use of these machines in the public interest...these machines have been used in clubs by many thousands of decent, respectable and normally law abiding citizens without any feelings of guilt or wrongdoing. The profits of the machines are used not for the personal enrichment of individuals but for the provision of furnishings, fittings, improvements and conveniences which are an asset to the district.

The basic tenets supporting the legalisation of gaming machines in NSW registered clubs in 1956 are unchanged:

- ◆ Gaming machines are not available to the general public.
- ◆ Gaming machines are inaccessible to children.
- ◆ The profits arising from the operation of gaming machines are used not for the personal enrichment of individuals.
- ◆ Profits from gaming machines are applied to the provision of furnishings, fittings, improvements and conveniences that are an asset to the district.

5.2.2 Rates of Gaming Machine Duty

In each Australian State or Territory that has legalised the operation of gaming machines in a range of venues, the gaming machine duty structure recognises the critical difference between community owned gaming and privately owned gaming that was alluded to by the Hon. R.R. Downing (see 5.2.1).

Differential gaming machine duty rates reflect the basic difference in the underlying purposes of community owned and privately owned gaming in Australia.

- ◆ Clubs recycle their gaming revenue back to the community, either through the provision of services and facilities to patrons, or through a range of cash and non cash community support mechanisms (see further annexure 1, 2 & 8).

Private operators of gaming throughout Australia conduct their business on the basis of maximising shareholder/proprietor wealth, ie creating economic benefit for specific individuals.

5.2.3 The Consequences for Clubs of Access to Gaming Machines – Commercial Considerations

The entitlement to conduct gaming is recognised by the Club Movement as a privilege not a right. Clubs, throughout the period since gaming machines were legalised in New South Wales have respected this privilege.

Co-operative development of effective legislation, adherence to legislative requirements including security and integrity measures, disclosure of performance to members, free and open elections of clubs' boards, diligent adherence to the objects as described in their Constitutions and continuing support for that section of the community that extends beyond clubs membership have been the norm for operators of community owned gaming.

There can be no doubt that "the major social impact of clubs came about as a direct result of the licensing of poker machines in the mid-1950s. This together with licensing law amendments (which relaxed the limits on the number of clubs that could be licensed) and the atmosphere in which machines were presented, saw an expansion of the Club Movement which was neither predicted or planned, and has culminated in the huge leisure industry that clubs represent today.¹³"

The community, through the club structure has responded to its own requirement for a wide range of cultural and recreational services and facilities delivered at an affordable price. Both the number of clubs and club patronage have expanded primarily because clubs operate for the benefit of the community without the incentive to create financial gain for individuals in the style of private operators of gaming venues.

The financial impact of the operation of gaming machines by clubs is discussed further in annexure 1 to this submission.

¹³ Directors Guide, 5th Edition, The Registered Clubs Association of New South Wales.

6.0 Clubs Commitment to the Community

By their philosophy, and by legislative requirement, clubs are committed to meeting the needs of their membership. Club membership is estimated at nine million. This figure represents approximately 64 percent of the adult Australian population. In addition, and not included in this statistic are the large number of adults who patronise clubs either as members guests or as temporary members/visitors.

A number of clubs maintain stringent restrictions on their membership, excluding or strictly limiting visitors access to the clubs facilities and services. However the diversity of objects and geographic spread of clubs usually mean that membership is available to a significant component of the community who have attained majority. In addition, many clubs, particularly of the sporting orientation, offer junior membership in strict accordance with legislative provisions.

In addition, clubs are pro-active, if not always visible, in their support of community projects. Annexure 8 provides a listing extracted from the PKF and Working Party surveys undertaken in 1997-98 referred to in section 3 above which demonstrates the scope of clubs commitment to the community.

7.0 The Club Movement's Response to Controversial Issues

Through the Inquiry process, interests associated with the operators of privately owned gaming and wagering venues, and other critics have called into question the integrity of the Club Movement and the appropriateness of the Federal and State/Territory taxation regimes that apply to clubs across Australia. The Club Movement takes this opportunity to focus on a number of controversial issues in an attempt to provide insight into the logic of maintaining the existing differential treatment of club revenue.

Three simple principles underwrite this differential treatment.

- ◆ Clubs are non-profit, mutual organisations. Members' contributions are applied for the benefit of those members in accordance with their instructions. As such, these contributions are not income and are not subject to Federal taxation. Expenses associated with members' activities are similarly not deductible.
- ◆ Clubs revenues are recycled to members through the provision of facilities and services and to broader community purposes.
- ◆ There is no leakage from this cycle that benefits individual club members.

Community owned gaming and privately owned gaming have fundamentally different objectives.

Enhancement of the welfare of the community is the underlying reason for existence of clubs.

Maximisation of shareholder/proprietor wealth is the justification for investment by private enterprise (whatever its legal identity or scale of operations) in the provision to the public of a range of gaming and wagering products.

This fundamental difference continues to justify the differential taxation treatment afforded clubs across Australia.

Item:

Implications of the removal of the application of the principle of mutuality to the club industry, such that all club receipts would be taxed at 36%, irrespective of source.

Issue:

The principle of mutuality should not apply as it provides an unfair tax advantage to clubs. All club receipts should be taxed at 36%, rather than the current practice of only taxing non-member receipts.

Club Movement's Response:

What is the principle of mutuality?

- ◆ The principle of mutuality provides that members' pooled funds are not income because these funds do not represent an economic gain from an external source.

Why generate surpluses?

- ◆ Clubs attempt to generate surpluses in order to optimise benefits firstly, for members and secondly, for local communities as a whole. These benefits are both internal and external.
- ◆ Clubs and community owned gaming benefit a large number of Australians. Some nine million Australians are members of the 5600 plus Australian registered and licensed clubs. Their combined "ownership" of gaming operations guarantees a high degree of public accountability and control over the gaming industry.
- ◆ Benefits are also available to that section of the community that extends beyond the clubs' membership, through access to clubs services and facilities via member's guest/temporary member/visitor status entitlements and through significant direct and indirect, cash and in kind, formal and informal community support programs. (refer annexure 1, 2, 8, 9 & 10)

Size is immaterial

- ◆ The size of the club is immaterial to mutuality, as the larger the club the greater the membership, and the more extensive the facilities available to these members and to that section of the community that extends beyond the club's membership.

- ◆ Increasing the size of the club is often a necessary step to obtaining operating efficiencies and generating revenues adequate to fund member and community support programs.

Club versus private enterprise

- ◆ The application of the principle of mutuality is appropriate for all community owned clubs, as they are legally required to reinvest their revenue to meet the requirements of their members and the community. This may be contrasted with privately owned gaming and wagering operators that may channel surpluses through a variety of means to their proprietors/shareholders.

Proliferation of clubs and scale of clubs operations

- ◆ Clubs growth is a function of the community's demand for the services and facilities provided by clubs. Clubs are non-profit organisations that cannot distribute surpluses to their members - as such they do not seek to maximise individual shareholder/proprietor wealth through expansion or through the reduction or elimination of competition.
- ◆ Extension to and improvement of clubs facilities benefit both members and that section of the community that extends beyond the clubs' membership, including, but not limited to members' guests and temporary members/visitors to the clubs. Clubs facilities are also used by a wide range of community groups (refer annexure 1, 2 & 8). Clubs facilities have always been and continue to be "an asset to the district"¹⁴.

Purpose of growth - member and community benefits

- ◆ Clubs objects vary widely across the nation and within a suburb. Growth will be a goal of a club only if expansion is consistent with the club's objects and is in the interest, and at the behest, of its members.
- ◆ Growth typically anticipates an increase in both the numbers of club members and non-members using the clubs facilities. Non-member use of a club's facilities, resulting in profit generation will increase tax payable, because the total profit of the club has increased and/or the "mutuality percentage" will be adjusted to reflect a higher utilisation of the club by non-members.

¹⁴ Hansard 30.08.56 1979 - Second Reading Gaming and Betting Bill, The Hon.R.R. Downing.

Comparison to profit purpose of private operators

- ◆ In comparison, private operators of gaming have an underlying goal of wealth maximisation of the proprietors/shareholders. As a result, private operators may choose to channel surplus funds away from the venue (and typically out of the venue's locality), maximising immediate personal financial gain. Additional capital may be invested in the venue – through extension, renovation, upgrade of equipment etc if it is calculated that such action will yield an increase in the capital value of the investment (venue), and/or increase the earning potential of the business. This business decision is based on the potential of the investment to generate an appropriate return on capital committed to the project. Maximisation of shareholder/proprietor wealth remains the underlying goal.

Effect of tax on clubs

- ◆ Clubs have an underlying obligation to comply with their primary objectives, meeting the needs of its members. Accordingly, any negative impact on the surplus of a club would be expected to have a corresponding negative impact on the level of community support a club provides.
- ◆ Any tampering with the application of mutuality cannot be justified whilst ever clubs operate as not for profit mutual enterprises. Altering tax structures as a response to perceived competitive differences, can only result in a reduction in the level of member and community benefits provided.

Removal of common-law principle

- ◆ Mutuality is a common law principle that excludes receipts sourced from members from the taxation net. Registered and licensed clubs are therefore legally entitled to this taxation benefit which could only be removed by enacting overriding legislation, thereby voiding this common law principle.

Effect of removal

- ◆ Removal of the principle may theoretically benefit some clubs, since some services and facilities provided to members are performed at a loss. These losses are presently non deductible if provided wholly for the benefit of members, or only partially deductible if provided to both members and non-members. Removal of mutuality would result in these major outgoings becoming deductible to the club. Removal of mutuality could result in the losses being offset against profitable activities currently subject to taxation.

- ◆ Research suggests however, that many clubs, and probably the majority of clubs not exempt from taxation pursuant to Division 50 of the Act, would be disadvantaged by any adjustment to the current taxation regimes, at Federal or State level (see annexure 3 & 4), which operate to increase clubs taxation burden. As indicated elsewhere in this submission, additional financial pressures must impact clubs ability to provide the range of benefits that the community has come to expect from clubs.

Case specific impact

- ◆ The impact of the removal of the principle, or adjustment to its operation, is dependent upon the factual situation of each club. In order to determine the likely impact upon the club industry, it would be necessary to perform an extensive modelling analysis of different size and types of clubs.
- ◆ As a general principle, removing mutuality would be detrimental to a club's ability to apply its revenue to the enhancement of the position of its members and the broader community.
- ◆ Adjustments to the basic premise upon which clubs operate will cause each tax-paying club to reassess the way it manages its activities. Focus may shift from the achievement of the clubs objectives and meeting the needs of the local community to a more tax effective decision making style. One outcome may be a change in clubs guidelines for providing community support - moving from an "identified local needs" base to a prioritisation system that recognises that all community causes are not equal (deductible) in the eyes of the Commissioner. Specifically, there may be a shift from non-deductible community support to deductible community support. From in kind support to cash support. From indirect to direct support. Such a change in emphasis may impact both the overall quantum (value) of support and its effectiveness.

Item:

Implications of taxing clubs as companies including the ability to pay fully franked dividends

Issue:

Clubs should be treated like any other company - they should pay tax on all profits and have the ability to pay dividends.

Club Movement's Response:

Primary effects

- ◆ Imposition of any broad tax at 36% will impact on the level of clubs surpluses and is likely to decrease available members' benefits and community welfare support.
- ◆ The effect on the amount of revenue received by Treasury is ambiguous. Member specific activities of clubs are, in some instances, run at a loss and subsidised by other activities which generate receipts from non-members. Taxing activities that generate member receipts would not necessarily generate substantial revenue.

Payment of dividends alters nature of member/club relationship

- ◆ Payment of dividends to members allowing imputation credits to be utilised calls for a fundamental change in the nature of the club/member relationship. Currently club members are not entitled to the financial benefits generally available to the beneficial owners of private gaming operations, being shareholders, sole traders, partners, or beneficiaries of trusts. Hence, any adjustment to the taxation regime, including the entitlement of, or obligation on, clubs to pay dividends may result in a complete reappraisal of the manner in which business is conducted, including the adoption of tax planning, financial structuring, etc. to optimise members benefits - both financial and non-financial.
- ◆ The payment of dividends to members is at odds with the underlying non-profit philosophy and legal obligations of clubs. It would entail a fundamental shift in the overall philosophy of being a club member.

Failure to reinvest dividends

- ◆ The payment of dividends will result in a decline in funds available for non-financial benefits available to members and non-members using the clubs facilities and for support of the community at large.

- ◆ Members' personal taxation position and immediate cash flow priorities will impact the level of reinvestment of dividends in clubs.
- ◆ It is likely that any decrement in the reinvestment of club's revenues into services and facilities will eventually result in decreasing member participation in club activities, and finally in a fall off in the level of club membership. Revenues and profits are likely to decline, thus further decreasing the capacity of clubs to meet the community's expectations of services, facilities and other support.
- ◆ Administrative and compliance costs are likely to increase significantly.

Item:

Implications of ring-fencing activities of club

Issue:

Larger clubs run substantial commercial operations, hence all non-core activities should be taxed.

Club Movement's Response:

Effect of taxing

- ◆ Defining the term 'non-core' activity necessarily involves an examination of the reasons for a club's existence as defined in its Constitution. As described elsewhere in this submission, clubs are established for a wide range of legitimate reasons so what may be prescribed as 'prima facie' non-core, may on close examination be subject to challenge.
- ◆ However 'non-core' activities are defined, they are still the activities of a club. A club provides a whole range of services to meet the particular needs of its members and the community. It is inappropriate, if not impossible, to prescribe which activities may be non-core for all clubs.
- ◆ Taxation of non-core activities will impact negatively on the amount available to provide members benefits, and more broadly to the local community as a whole.

Clubs do not, in fact, necessarily run the non-core activities

- ◆ Non-core activities that appear to be run by the club entity (eg bakery or butcher, etc) often are not actually run as part of the club per se. A third party may enter into a management agreement with the club to conduct the business, or the relationship may rest on an arms-length landlord and tenant arrangement, etc.
- ◆ Effectively this results in profits of non-core activities being presently subject to income tax in the hands of the third party, not the club. In fact, if the arrangement is such that the butcher, for example, simply pays rent to the club for the premises, then that income will be taxable to the club as a non-member receipt.

Clubs operate activities to benefit local community

- ◆ Clubs may enter into arrangements to effectively rescue a service or activity that is otherwise not available, or would cease to be available, to the local community due to its low profit earning capacity. In the community's interest, the local club may foster continuance or introduction, of these activities. Examples are far ranging and include the provision of premises for the conduct of essential services such as post and banking etc to facilitation of funeral/undertaking services.

Item:**Removal of the Income Tax Exemption*****Issue:***

Larger licensed sporting clubs claim tax exempt status whilst undertaking what can be considered to be substantial deviations from the original purpose for which the exemption was granted.

Club Movement's Response:Exempt status

- ◆ Tax exempt status is only acquired through demonstration to the ATO of the relevant purpose.

Annual Test

- ◆ The club must satisfy this test each year.

Purpose of Sport

- ◆ Although significant social or commercial activities may be carried on by the club, as long as these are sub-ordinate or incidental to the encouragement or promotion of a game or sport, the club will satisfy the requirements for exemption.
- ◆ It must be noted that the revenue authorities are satisfied with the current basis on which monitoring of clubs is undertaken, as discussed in the Taxation Ruling 97/22.

Penalties

- ◆ If exemption status is granted, but the club is found by the ATO to actually operate in a way not reflective of the basis of the exemption, the exemption is likely to be withdrawn and the club will be liable to the shortfall of tax and penalties.

High proportion of Australian clubs related to sport

- ◆ In excess of half of the total number of clubs in Australia are directly related to the fostering of sport. Hence any alterations in treatment will impact substantially on the level of funds available to community causes and specifically, the promotion of sport.

Community need for sport

- ◆ While there is an ability to claim an exemption where commercial activities occur, activities in support of the community and national interest, health and well-being of the citizens of Australia is fostered. The exemption ensures the maintenance of a high level of support for sporting and other games.
- ◆ The level of national support for sporting activities can be seen by the number of clubs in Australia that directly sponsor sport on a significant scale. Further, many clubs, not designated as sports clubs, provide a wide range of sporting opportunities through intra club arrangements and/or sponsorship.

Item:

Clubs do not manipulate mutuality percentage to minimise tax

Issue:

Clubs have an incentive to understate the percentage of non-member visitors in order to minimise taxation liability.

Club Movement's Response:

No evidence of manipulation

- ◆ There is no evidence to suggest that clubs manipulate their non-member percentages in order to reduce their income tax liabilities.

Legal requirements for non-member patronage

- ◆ In determining their tax liabilities, clubs are required by law to maintain detailed records of non-member patronage and are subject to ATO tax audits and penalties if they pay incorrect amounts of tax.
- ◆ The ATO has issued guidelines for ascertaining the mutual income of registered and licensed clubs. These guidelines assist clubs in correctly calculating and reporting all non-member patronage.

Item:

Policy implications of alleged preferential treatment of clubs and gambling receipts

Issue:

It has been suggested that clubs are preferentially treated under the current taxation regime.

Club Movement's Response:

Why are clubs treated differently?

- ◆ All State/Territory Governments of Australia acknowledge that clubs should be treated differently to other providers of gaming products. This is evidenced by the differential gaming tax rates applied and the number and type of machines permitted in clubs compared to other gaming venues.
- ◆ The underlying rationale for this treatment is that clubs return benefits to the communities that support them and there is no private profit taking.

Gambling Receipts

- ◆ Taxation of gaming receipts generally favours clubs. Again, community owned gaming is treated in such a manner due to the fact that the revenues are returned to the community through the provision by clubs of services and facilities as well as community support to that segment of the community that extends beyond club patrons.
- ◆ In comparison, surpluses from privately owned gaming and wagering (hotels, casinos etc) are typically withdrawn from the community that supports the venue, and paid to the operators (proprietors/ shareholders).

Item:

General policy implications of increasing the rate of tax imposed on clubs

Issue:

By increasing the rate of tax imposed on clubs, Government can recover further funds to allocate directly to the community. This indirect method of collection and re-allocation is more effective than direct donations by clubs.

Club Movement's Response:

Independent value of club support

- ◆ A survey by PKF (refer annexure 2) showed that in 1996-97, NSW clubs provided some \$155 million in community support. A further \$280 million was re-invested in non-gaming related buildings, facilities and equipment.

Wide-ranging support

- ◆ The PKF report evidences that clubs provide a broad range of support to the community, substantially aiding the position of important minority groups including the least privileged members of society.

Relieve financial pressure on local councils

- ◆ Finally, observations were made in the PKF report on submissions by Government Instrumentalities, confirming that club donations and other community support relieved financial pressure on local Government to provide social, sporting and cultural infrastructures.

Efficiency of allocation through Government versus club

- ◆ Collection and allocation by Government involves incurring substantial administrative costs, effectively reducing both timeliness and efficiency of allocation.¹⁵
- ◆ Once the funds are allocated to local councils, costs will be incurred due to the process of deliberation, costs of considering applications for grants and effect on timeliness of receipt of money for the community purposes.
- ◆ In contrast, clubs' Boards of Directors are drawn from the communities in which they operate and they are attuned to the needs of their locality.
- ◆ Decision making is localised rather than centralised and reflects community expectations.

Item:

Implications of taxing member's benefits as a Fringe Benefit

Issue:

Liability should exist for benefits received by members to ensure the Australian taxing regime for clubs does not provide a competitive advantage.

Where the club pays tax on the benefit.

Club Movement's Response:

Where the club is liable for FBT:

- ◆ Non-taxed benefits provided to non-members will become more attractive. This may promote a shift in the nature of benefits provided to members as clubs seek to effectively manage their taxation liability.

Effect of payment - surplus decline

- ◆ Where the club must pay FBT on benefits provided to members, the surplus of the club will decline. Thus, the level of benefits provided by the club to both members and the broader community is likely to decrease.

¹⁵ NSW Treasury Submission to the Independent Pricing and Regulatory Tribunal Inquiry into Gaming, August 1998.

Inconsistent relationship nexus

- ◆ Technically, a member is not an employee of the club. The relationship of member/club is vastly different from the relationship between employee/ employer, on which the FBT regime is based.
- ◆ Such a measure would result in the destruction of a relationship that represents the very heart and soul of the Club Movement.

Administrative issues

- ◆ Administration of a FBT on all member benefits would prove administratively difficult, imposing substantial compliance costs on both club administration and the ATO.
- ◆ Increasing compliance costs will be in addition to the tax itself, thus decreasing the funds available to further member and community needs and interests.

Where the individual member pays income tax on the benefit:

Club Movement's Response:

Overseas taxation

- ◆ Employment benefits are taxed in the hands of the individual in many overseas jurisdictions such as the United Kingdom and the United States.

Inconsistent relationship nexus

- ◆ Again, technically a member is not an employee of the club. The relationship of member/club is vastly different from the relationship between employee/ employer on which the overseas regimes tax employment benefits.