PARLIAMENT OF AUSTRALIA • THE SENATE

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Mr Gary Banks
The Chairman
Productivity Commission
Locked Bag 2, Collins St East PO
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Dear Mr Banks

I refer to your Draft Report into Australia's Gambling Industries, and enclose two speeches of mine on abuse of the 'mutuality principle' dated 5 March 1997 and 18 October 1999.

I hope that you will be disposed to take my views into account, that for sound public policy and good tax practice reasons, the mutuality principle concession must be considerably tightened up.

Yours sincerely

Senator Andrew Murray
Australian Democrats : Western Australia
Spokesperson for Taxation

[P R O O F]

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ADJOURNMENT
Taxation: Clubs

Senator MURRAY (Western Australia) (10.27 p.m.)--In my adjournment speech in the Senate on 5 March 1997, I outlined my concerns over loose taxation exemptions extended to the club sector through the mutuality principle. In a most inadequate assessment on pages 228 and 229, the Ralph report assessed this issue. They missed a chance to address a major tax avoidance matter.

The club sector has continued to grow exponentially since I raised my concerns in 1997. Large clubs throughout Australia have diversified into a broad range of commercial activities that are outside their original community based charter. The industry is now involved in operating accommodation properties, ski lodges, cinemas, IMAX theatres, gymnasiums, travel agencies, bus services, hairdressing businesses, bakeries and butcher shops through huge taxpayer subsidies. These enterprises have been enjoying major taxation concessions and exemptions and, in many cases, have resulted in small and local taxpaying businesses being unable to compete with their larger tax-free competitors.

In addition to the multimillion dollar expansion projects undertaken by clubs that I highlighted in 1997, there has been additional building completed and planned for the future. For instance, there is the Twin Towns Services Club in Tweed Heads construction of a $46 million project incorporating a parking station, retail stores, an overhead pedestrian bridge, a hotel and apartments. Additionally, a major buying group, formed in conjunction with Harvey Norman, further emphasises the big business approach of the major clubs. These expansions are undoubtedly commercial enterprises and should be taxed appropriately.

Sporting clubs, where sport is the dominant activity, are presently exempt from paying tax on all their net income, while clubs that partake in more diverse activities are assessed on the Waratah principle, which I believe is now outmoded. The Waratah principle is related to identifying different tax rates for each type of income stream and applies subjective tests under the self-assessment taxation regime. This self-assessment has led to great difficulty in the policing of this tax exemption by the Taxation Commissioner.

The loophole in the mutuality principle must be reformed. The large super clubs continue to dominate, adding to the concerns of not only private business but also smaller clubs that are, in fact, operating within their original charter and are within their right to claim the mutuality principle exemption.

It has become obvious that the smaller clubs are facing the same pressures from super clubs as private enterprise. The larger clubs within Australia not only continue to expand but have begun 'McDonaldising' their venues. A number of clubs now operate in excess of five venues under the one banner, with no signs of these clubs slowing their aggressive expansion plans. This form of corporate takeover has resulted from the largest clubs enjoying super profits and being in a cash rich position that has enabled them to continue to capitalise and expand.

The Australian Democrats support the notion of community based organisations and clubs and view smaller, tax exempt club enterprises as legitimate community organisations. The large super clubs, however, are clearly major multimillion dollar commercial enterprises that must be taxed appropriately. Adding further weight to this argument is the relaxed membership process that is employed by the club sector, coupled with marketing initiatives reflecting only nominal regard for the club laws preventing advertising to the public and

designed to attract not only local residents but also international tourists. Interestingly, I have been made aware of at least one club now operating marketing offices in overseas locations encouraging overseas tourists to utilise club facilities.

The recently released Productivity Commission *Draft report into Australia's gambling industries* examined the mutuality principle in detail. Based on Australian clubs' operating profits of $561 million for 1997-98, on page 20.10 of its draft report the Productivity Commission estimated that the government would collect $202 million per annum in taxation revenue if the club sector were taxed at the company tax rate. Other industry sources have suggested that the commission's figures are conservative. The majority of this revenue is generated from the club industry's access to gaming machines and other gambling facilities. In its draft report the commission stated:

> There has been a large expansion of part of the club sector in some States and an increased concentration on gambling as their main business. This has skewed the traditional nature of clubs--and has led to the development of super clubs. This then raises the question of whether the club cocktail of mutuality, and a heavily and rapidly growing dependence on gambling revenues by a segment of the club industry, is one which policy makers should accept without restraint.

It is clear that we, the law-makers, should not encourage the continued expansion of this industry through providing taxation exemptions not afforded to other sectors of the community. The mutuality principle is being rorted and is a gross example of an abuse of the taxation system.

The mutuality principle has made it possible for clubs to invest in thousands of gaming machines with no regard to the community's best interests. In New South Wales, for example, the Penrith Panthers Club is currently undergoing major expansion and is on track to be the largest gaming machine provider in New South Wales--larger than Star Casino--and the second largest in Australia, being only slightly smaller than Crown Casino. The Productivity Commission also found that some clubs currently obtain 80 per cent or more of their total revenue from gaming machines--again higher than is found in some casinos. The commission has stated:

> In summary, the Commission considers that the exemption of club mutual income from tax, combined with the inability to distribute surpluses to members, has the potential to result in excessive capital allocation in club facilities and other investments.

In my adjournment speech in March 1997, I suggested that there could be merit in ensuring that a figure of, say, four per cent of turnover must be placed back into the community in which these clubs operate. Another alternative is to set a threshold figure at which clubs demutualise and become tax paying entities. I suggest a figure of $1 million turnover as an appropriate amount, a figure used in the Ralph Review of Business Taxation as its basis for the definition of a small business.

Another alternative to this policy approach would be to amend the definition in section 23(g) of the Income Taxation Assessment Act 1936 to require such clubs to satisfy a purpose test each year comparable to the sole purpose test that applies in superannuation legislation. The government faces considerable problems with ensuring that business taxation reform remains revenue neutral. It has consistently stated that all sectors of the community should pay their fair share of taxation. But it has ignored the rich commercial club sector throughout the reform process, despite the major concessions currently extended to the sector. Conservative estimates of $200 million in tax forgone are truly significant.

If the government wishes to ensure revenue neutrality and a fairer and more equitable tax system, it is imperative that this issue be addressed and tightened to reflect a truly progressive, efficient and fair tax system. As I asked in 1997, will the government now review this situation? If it did so and applied appropriate tax rules, it would also assist small business competitors that are being unfairly disadvantaged, would provide revenue to assist in reducing the current revenue shortfall due to the business taxation reform process and would further contribute to the government's budgetary needs. The time has come for the club mutuality principle to be reformed and for $200 million to be raised to fill the black hole which presently exists with the Ralph package.

ADJOURNMENT
Taxation
Licensed Clubs

Senator MURRAY (Western Australia)(7.33 p.m.)—There are 4,946 liquor licensed sporting and community clubs throughout Australia. The Australian Democrats are concerned that many private licensed registered clubs are undertaking activities which can be considered as a substantial deviation from their original purpose whilst still being able to claim a tax exempt status. Therefore, they are competing in the marketplace with an unfair advantage over their competitors who are required to pay taxes. It is not even compulsory for all clubs to submit tax returns.

The competitive advantage to clubs which is derived from their tax exempt status is an important example of major distortions in the Australian tax system. It is also a perfect example of where the government could raise revenue to meet pressing budgetary needs. Conservative estimates show that $85 million could be collected annually by the government.

The private licensed registered club industry in Australia is afforded tax-free status on income derived from members. The favourable income tax treatment is through the principle of mutuality. The mutuality principle provides that, where a number of persons contribute to a common fund that is created and managed as a common interest, any excess earnings that are generated from the use of the fund are not, for the purposes of taxation, to be considered income. This is an excellent system. But it is only excellent where it is not abused—and it is abused.

In essence, private licensed registered clubs are only assessable for taxation that is earned from trading with non-members. The determination of taxable income of non-members is based on what is known as the Waratah principle. That principle is derived from the Waratah's Rugby Union Football Club v. FCT, 1979, 10 ATR 33-79, which is now probably outmoded.

The question that this raises is the matter of the regulation of sign-in procedures in clubs. [start page 1376] The enforcement of membership amongst its customers by a club is of major concern from a tax point of view. It is in the interests of licensed clubs to be less vigilant in the policing of the numbers of non-members in a club and, therefore, this clearly serves as an incentive to distort the level of income that is declared for taxation purposes.

This results in many clubs having an unfair advantage over hotels and other tax paying businesses, including gymnasiums, travel agents, bus operators, hairdressers and butchers. The current situation has a severe effect on the hotel and other associated hospitality and service industries. If left unchecked, it will undoubtedly result in reduced investment in those industries, many of which are small businesses, which will result in being to the detriment of Australia as a whole.

The loopholes need to be tightened up. Government happily tightens the budget and tax screws on ordinary Australians. But clubs which abuse these loopholes are so far escaping the net.

The fact that large clubs do not have to pay income tax on their gaming operations means that other operations of the club can be subsidised, including food and beverages, entertainment and accommodation, along with undertaking further activities and capital expenditure. The major influence of the large clubs appears to be in New South Wales, Queensland and the Australian Capital Territory. The benefits for `members and guests' in accessing cheap subsidised club operations—including dining and bar facilities, gym and entertainment—in these areas are to the detriment of taxpayers in the other states and territories and in the entertainment industry.

Evidence that clubs are using their tax concessions to threaten private enterprise includes the disclosure by the Treasurer (Mr Costello) on 13 December 1996 that New South Wales clubs have not paid any income tax on more than $138 million derived from the Club Keno electronic lottery game. The club industry apparently faces up to $50 million in back income tax alone on Club Keno.

Documentation shows that 34 clubs have not paid income tax on a combined revenue of $80 million, including $8.9 million and $6.9 million tax-free to the Manly-Warringah and St George rugby league football clubs respectively. Over $1.1 billion is spent annually by New South Wales clubs alone on capital works, plant, refurbishment and new poker machines. That expenditure

includes: a proposed $50 million development at the Blacktown Workers Club; a $30 million club hotel at Gosford Leagues Club; and a $100 million development at Canterbury Leagues Club, including a 240-room hotel. Those are very large businesses. They are hardly clubs in the general sense of the word.

Examples of the limited amounts of tax being paid by clubs include the Panthers Rugby League Club, where the club paid only 1.4 per cent income tax on its 1996 profit of $4,482,459. This is despite the fact that Panthers, which had a 1996 revenue of $83 million, received $596,330 in interest in 1996 and has admitted that up to 60 Taiwanese tourists, who cannot possibly be Panthers members, stayed at the club and played the poker machines each night. These are businesses, not clubs and, like many clubs, these are part of the entertainment industry. Panthers are directing some of their profits into a $22 million 16-screen cinema complex which they announced in October 1996. The cinema will compete with private enterprise cinema complexes.

Concern has also been expressed at the fact that the level of community contributions from clubs is not accurately measured. The role of clubs should be to support community projects in sport or welfare. Many do, and the Australian Democrats strongly support the continuation of that community service. But there are many cases in which it can be shown that clubs are paying nothing or a very small percentage of their profit back to the community. This is an unacceptable distortion and manipulation of the tax system.

The Australian Democrats support the proposal whereby the commercial activities of private licensed registered clubs which are operating as a business should be subject to company tax as any other business enterprise. [start page 1377] Clubs should also be obliged to pay a mandatory sum to community organisations as part of their charter. Apparent constraints on the Taxation Office and the courts to effectively interpret the current taxation exemption in respect of clubs should be removed by both legislative change and a more vigorous enforcement and evaluation procedure.

One proposal that I am aware of is that section 23(g)(iii) of the taxation laws should give effect to a test that clubs show that the principal activity of that club is in accordance with the original objectives of the club. The effect of this change would be that where clubs have a principal activity relating to social activity, as distinct from sporting or community activities, then there would be definitive guidelines whereby the tax office would be in a position to review those clubs in order to reassess their taxation exemptions.

A further proposal is that a mandatory donation of, say, four per cent of gross turnover be paid by each club to registered charities and community organisations, provided a certain level of profit or surplus is achieved. A conservative estimate of the possible tax revenue arising from such proposals is $84 million annually and a community benefit of $186 million based on the mandatory donation of four per cent of gross turnover.

The Australian Democrats would ask that the government review this situation and believe that this situation must be addressed as a matter of urgency to assist small business competitors that are being unfairly disadvantaged, to provide revenue to assist in reducing the deficit currently facing this government and to contribute to government's budgetary needs.