



Clubs Australia
& New Zealand

CLUBS AND TAX VALUE METHOD

Introduction

Clubs Australia & New Zealand (CANZ) appreciates the opportunity to provide the Board of Taxation (the Board) with its views on the Tax Value Method (TVM). CANZ is the Club Movement's federal umbrella organisation comprising the representative club bodies in each Australian jurisdiction and New Zealand.

Currently, income tax arrangements for clubs are underpinned by the principle of mutuality along with income tax exemptions (under the Income Tax Assessment Act 1997) for those established for the encouragement of sport, music and literature.

Changing the method of determining taxable income could have serious implications for clubs and we are concerned that the prototype legislation being developed should be workable, fair, and not disadvantage mutual entities such as clubs.

An Overview of the Club Movement

Clubs by law are not-for-profit community based organisations, formed by people with common interests, to pursue those interests that play an important part in Australian life.

Clubs provide a range of entertainment and family services which many groups in society, especially the elderly, would normally not be able to afford or enjoy with the same frequency. Clubs provide these groups with the opportunity to consume recreation and entertainment at an affordable price in a safe environment.

A 1999 ACNielsen study of NSW clubs found that around 54% of NSW adults are members of a club, representing 2.5 million members across the State, with 80% of the population having visited a club within the last 12 months. The same study showed that people attend clubs to socialise, access sport and fitness facilities, and consume food and beverages at reasonable prices.

There are approximately 3,900 licensed club premises in Australia. Clubs are important vehicles for economic activity within their locations, particularly with regard to employment. For some localities the club is critical to the economic health of the district.

Current Income Tax Treatment of Clubs

Registered and licensed clubs in Australia are considered mutual organisations. The reasons for this are as follows:

- a) Clubs are non-profit associations. As such, club goals are not to maximise return for shareholders. As well, if a club is wound up, any remaining funds must be distributed to a comparable non-profit organisation or charity;
- b) Clubs are comprised of members, who pay an annual membership fee. Any surplus derived from members trading between themselves can be regarded as additional money invested beyond the cost of the consumed products or services and therefore as savings;
- c) Club members have no property rights to their share of the common fund. When members cease to be members they lose their right to participate as members but do not receive any financial benefit when relinquishing their membership; and
- d) Club surpluses are not distributed to members as dividends; they are instead reinvested in the club, paid out in taxes, and distributed to the community.

Club income is subject to company tax at the prevailing rate, currently 30%, unless the specific provisions of the Income Tax Assessment Act 1997 (Section 50-45) exempt income generated by a club with the dominant purpose of encouraging or promoting sport, music and literature.

Additionally, through common law exclusion, under the mutuality principle, revenue derived from members is exempt from corporate income tax. Mutual income arises when the price for club services exceeds their cost. However, revenue derived from non-members is fully taxable under the corporate tax system, and costs reducing corporate tax liability of non-member revenues are related to non-members only.

Because determining the exact proportion of revenue related to members versus that related to non-members is complex and administratively infeasible, the Waratahs formula was established to approximate proportion of revenue assessable. The Waratahs formula is based on the assumption that the level of expenditure by non-members is the same as that by members. In order to determine the ratio of members to non-members attending the club, clubs keep a register of members' guests and visitors and take surveys to determine the percentage of members attending the club each day.

The Waratahs Formula was named after a decision in *Waratahs Rugby Union Football Club v Federal Commissioner of Taxation* (1979) 10 ATR 33; 79 ATC 4337). The proportion of income that is assessable (p) is:

$$p = \frac{(B \times 0.75) + C}{(R \times S \times T) + A}$$

Where:

A = total visitors for the year of income. This can be determined through the visitors' books.

B = members' guests. That is, visitors who are accompanied to the club by a member. Waratahs Formula assumes that 75 per cent of members' guests contribute to the club's assessable income. The other 25 per cent are non-paying guests or non-working spouses of members.

C = $A - B$

R = average number of members for the income year

S = the percentage of members that attend the club on a daily basis; this can be determined by regular surveys of clubs.

T = the number of trading days for the income year

Ralph Review of Business Taxation

The 1999 Report of the Ralph Review of Business Taxation recommended in section 5.6 that:

- a) the current common law exclusion from the calculation of taxable income of mutual gains be given explicit effect in the tax law, notwithstanding the general tax principle that income arising from dealings between entities and their members should be included in the taxable income of those entities; and
- b) appropriate provisions be established for ensuring that all expenditure of mutual entities is equitably apportioned between exempt mutual gains and taxable income.

CANZ supports these recommendations along with Ralph's broad objective of achieving simpler and more transparent tax laws.

The Impact of TVM on Clubs

The TVM goal of reducing complexity, inconsistency and volume of income tax law is one we support in principle. However, changing the method of determining taxable income could have serious implications for clubs and we are concerned that the prototype legislation, and the Board's eventual recommendation to the Commonwealth, be workable, fair, and not disadvantage not-for-profit and mutual entities including clubs.

Uppermost in our thoughts are the principle of mutuality and income tax exemptions for clubs established for the encouragement of sport, music and literature. It is vital that these basic elements of the tax system, that have served the community well over many years, be preserved under TVM and incorporated into the prototype legislation in

a suitable form. The required special rules and adjustments that apply to categories of taxpayers such as clubs should be developed in consultation with CANZ.

Another concern associated with the introduction of TVM is that clubs, along with the rest of the Australian business community, are still coming to grips with significant changes introduced as part of the Commonwealth Government's tax reform agenda. The New Tax System has fundamentally altered the way in which businesses calculate and collect tax. In our opinion these monumental changes, largely represented by the introduction of the GST, are still being bedded down by businesses and the implementation plan for TVM should be sensitive to these circumstances.

Additionally, it is vital that the introduction of TVM be smooth and without significant transition costs associated with adapting business and financial accounting systems. It should not increase business compliance costs and ideally should reduce them. Additional costs attending the move to TVM will adversely impact Australian businesses, particularly not-for-profit and mutual entities unable to absorb costs associated with transition and compliance.

Conclusion

All business tax reform, including TVM, needs to be thoroughly tested with the business community. The Board has so far shown its preparedness to work cooperatively with business and it is important that this continue.

As indicated earlier, consultation and analysis is incomplete in the areas of special rules and adjustments for not-for-profits and mutual entities, and implementation costs. Toward this end, we are hopeful that the Board will work cooperatively with clubs to achieve the appropriate outcome.

As part of this process the Board has stated that case studies will be developed to demonstrate how the TVM could work for not-for-profit or mutual entities. CANZ would be happy to assist the Board in this respect.