



**Clubs Australia**

**RESPONSE TO THE  
PRODUCTIVITY COMMISSION DRAFT REPORT:  
CONTRIBUTION OF THE NOT FOR PROFIT SECTOR**

**NOVEMBER 2009**

## INTRODUCTION

ClubsAustralia welcomes the opportunity to provide comment on the Productivity Commission's draft report, *Contribution of the Not-For-Profit Sector*.

The report advocates a number of positive recommendations to reduce the sector's compliance burden, improve access to training for volunteer boards and the measurement of the sector's contribution to the community. However, the draft report has failed to acknowledge or value the significant employment, income, volunteer, in-kind and charitable contributions that registered and licensed clubs make to the community.

This is disappointing as the report's Terms of Reference clearly requires an analysis of the club contribution. The Commission instead asserts that lower gaming tax, mutuality and sporting club exemptions for not-for-profit (NFP) clubs has created a competitive neutrality concern with regard to clubs competing with for profit entities. The draft report then proceeds to question the effectiveness of the club model of support, in comparison to that of individuals and government in the allocation of resources for community need.

ClubsAustralia is of the strong belief that the contribution of the nation's clubs to the sector needs to be properly measured and understood before any recommendations on the merits of club taxation and community support can be made.

As is the case with many not-for-profits the club contribution is not fully understood due to a lack of national data on club activities. Despite this it is clear from state and territory based information that clubs provide flexible, targeted and locally based funding in a way that neither governments nor individuals could match.

Club funding to the community is unburdened by the complex reportage and accountability frameworks that Government employ in the granting of funds, leaving club funding more accessible and flexible in comparison.

Importantly, clubs' funding is also not exposed to the volatility of an electoral cycle and the shifting priorities of political parties in their pursuit of electoral approval. So unlike Government, clubs are more likely to allocate funds over a greater time frame to the causes and facilities they have been established to support.

Given that nationally clubs account for approximately \$10 billion in revenue per year, equating to approximately 20% of all (non Government sourced) not for profit income we believe that the nation's clubs deserve separate analysis by the Productivity Commission.

The Assistant Treasurer advised ClubsAustralia that whilst the ABS could not establish a more accurate register of clubs, the Productivity Commission's report would take into account the limitations of the ABS estimates used to measure clubs. This has not taken place as no mention of such limitations is contained within the draft report.

The Assistant Treasurer further advised ClubsAustralia that a preliminary estimate conducted by the ABS concluded that the 'missing' clubs unaccounted for in the survey would account for 3% of total income for the NFP sector. This estimate only adds to our concerns that the contribution of clubs to the sector is not adequately considered in this preliminary report.

If the current taxation regime for clubs were to be altered as suggested it would be highly detrimental to not only clubs and the way they serve the community, but also the wider NFP sector that would cease to benefit from the integral in-kind and financial support clubs provide.

### Competitive Neutrality

If economic principles had to be strictly followed in all facets of modern business practice, registered clubs throughout Australia would be in breach of competitive neutrality principles. However we believe that the principle has little merit in so far as the operation of Australian not-for-profits (NFPs) is concerned. Furthermore, the differing treatment of clubs is justified on cost-benefit analysis.

Importantly, NFPs are not the only entities to receive concessional tax rates that might be affected by strict application of the competitive neutrality principle. Small business in most jurisdictions is eligible for an exemption from payroll tax that competing medium and large sized businesses cannot claim. And the importance of certain industries, such as agriculture and auto-making, to employment or manufacturing is often emphasised to justify Government grants and other assistance that breaches competition principles. ClubsAustralia believes the structure of NFPs means they trade at a commercial disadvantage to for-profit entities and that, combined with their contribution to the social good, justifies the tax concessions NFPs are entitled to.

### **ClubsAustralia believes there is a strong case for the Commission to condone the maintenance of the current taxation regime for all NFPs.**

The Commission's draft report essentially argues that clubs receive a significant competitive advantage from tax exemptions that appear to be extended to services beyond their traditional social, cultural and sporting functions. The report suggests that this leads to two potential competitive neutrality issues which could result in 'undesirable' economic outcomes such as inefficient investment activities outside the traditional scope of services provided by clubs.

The argument advanced by the Commission that these 'output tax' concessions provided to clubs compromise competitive neutrality appears to be inconsistent with its own economic analysis that output based taxes are non-distortionary. Moreover, the argument advanced by the Commission that clubs use this implied competitive cost advantage to embark on inefficient or distortionary investments outside their traditional scope of services appears to be inconsistent with the clear mandate of all clubs to maximise profits for the benefit of their members and the community. None of the arguments advanced by the Commission in the draft report appear to be substantiated with empirical evidence or case study evidence.

The Commission itself argues competitive neutrality issues are not present in cases where not-for-profit (NFP) entities are exempt from taxes on their output, (e.g. income tax exemptions). This is because, where NFP entities receive income tax exemptions, the incentives facing them are the same as the incentives facing for-profit (FP) entities, which is to maximise profit. For example the Commission states:

“The objective of a for-profit business is to maximise profit by either (or both) increasing revenue or cutting expenditure. For a given profit, the tax on the profit (income tax) does not affect the decision to maximise profit (although a sufficiently higher income tax could make the business unviable). **This applies similarly to income tax exempt NFP’s which seek to maximise their output for a given cost**”. (emphasis added)

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

The Commission finds that clubs receive general income and gambling tax exemptions. It is important to note that these are output-based (profit) tax exemptions as opposed to input-based tax exemptions. For example, tax paid on gambling revenue is clearly a tax on the output of gambling. A tax concession on the input of gambling would take the form, by way of example, of a tax concession on the purchase of gambling machines: however, governments do not provide such a concession to clubs.

As a consequence, in line with earlier analysis presented by the Commission, the output-based tax exemptions granted to clubs would not be expected to distort resource allocation or reduce competition. For example, it is quite evident that tax concessions to clubs on gambling revenue do not reduce the cost of purchasing or operating gambling machines. In turn competitive neutrality issues would not be expected to be present.

It is therefore interesting that that the Commission suggests that the output tax exemptions provided to clubs raise two competitive neutrality issues, namely that:

1. Clubs have a competitive advantage over hotels and other entertainment venues in providing gaming facilities; and
2. Clubs use this competitive advantage to subsidise inefficient investment in other ventures such as shopping centres because they can generate significant surpluses, aided by tax concessions, and have no need to distribute dividends to shareholders. This gives clubs a competitive advantage in raising capital needed for commercial developments.

Each of these perceived competitive neutrality issues are discussed below.

#### Discussion on first competitive neutrality issue

The argument advanced by the Commission that the output tax concession to clubs compromises competitive neutrality appears to be inconsistent with the Commission’s own economic analysis that output based taxes are non-discretionary. The output tax concessions received by clubs do not appear to have any direct influence on the price paid by clubs for inputs, such as labour. This would be different if clubs were to receive payroll and/or FBT tax exemptions: however, this is not the case. As a consequence, clubs do not receive any apparent competitive cost advantage over hotels and other entertainment venues which they can exploit to attract customers and build market share.

This is illustrated by the fact that consumers of gambling services are not aware of any difference in the marginal tax rate paid on gambling revenue by clubs and hotels. While there is often a higher Return To Player in clubs, this relates to the impact of scale rather than tax. As a result, the differential in tax rates does not result in a price signal being sent to consumers that would provide an incentive for consumers to gamble at clubs, rather than hotels.

As a consequence, the argument advanced by the Commission that the relatively stronger gambling revenue growth enjoyed by clubs compared to commercial hotels and entertainment facilities is due to competitive advantage provided by the tax exemptions clubs enjoy appears to be unfounded. The Commission has not provided any evidence that this is occurring in practice or considered the simple proposition that the reason clubs might have experienced above average growth is due to superior strategy, management and customer focus (i.e. essentially better business management).

#### Discussions on the second competitive neutrality issue

The Commission infers that clubs use their implied competitive advantage, a proposition that it does not appear to have adequately established and substantiated, to make inefficient investments in other ventures. The magnitude of this claim is quite significant. The Commission is essentially implying that clubs are using the revenue from their members to embark on sub-optimal, large scale investments which would be in breach of the clear mandate of all clubs to maximise their surpluses for the benefit of their members and the broader community.

The absence of a need to distribute dividends to shareholders does not alter the same economic incentives clubs have as their FP counterparts to maximise surpluses. Clubs have a responsibility to maximise surpluses for the benefit of their members, which can be reinvested into better services and facilities.

Accordingly, the suggestion by the Commission that clubs are using their implied competitive advantage to make inefficient investments is inconsistent with economic theory. If clubs are nevertheless doing this in practice, then it is incumbent on the Commission to provide sufficient evidence of this. For example the Commission states that:

“Concern has been expressed....that some very large clubs are expanding - or planning to expand - into areas where they will provide goods and services to non-members, competing against the profit sector”.

However, the Commission does not actually provide any empirical or case study evidence of this. In the absence of evidence that clubs are using an implied competitive advantage to subsidise inefficient investment in areas outside their traditional scope of service, it would appear that the Commission is advocating for a heavy handed approach to address a hypothetical and apparently unsubstantiated market failure with an actual change to government policy that would result in actual change in the club industry.

The suggestion by the Commission that clubs use their implied cost advantage to have an advantage in accessing capital has also not been supported by any evidence. Indeed, this is contrary to the financial challenges that many clubs are facing on the ground. For example, a recent KPMG report prepared for ClubsNSW found that many clubs are facing lower capital investment and a reluctance of banks to lend to the industry.

The KPMG report found that with declining cash earnings and the current economic conditions, clubs have a reduced capacity to reinvest. Over time, this leads to deteriorating facilities and clubs losing their market appeal, thereby exacerbating declining trading performance. Furthermore, with an increasing number of clubs experiencing financial decline and the industry seen as having an uncertain future, banks are either reluctant to lend to the industry or will do so with onerous and restrictive covenants. A number of clubs interviewed as part of the case study process in the KPMG report were required to renegotiate their existing loan facilities with more stringent undertakings. Specific conditions included restricting levels of capital expenditure or discretionary donations, such as to charities and sporting organisations.

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

### Limited funding sources for NFPs

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

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

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

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

Clubs can not fulfil their sporting and social purposes through bake sales. Quality infrastructure, maintenance and other costs required by the sporting community are too high. Our not-for-profit purpose makes us believe, on the basis of advice from Senior Counsel, that the Word case has application to clubs and other NFPs. Clubs need to be professional operations capable of generating

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<sup>1</sup> *Commissioner of Taxation of the Commonwealth of Australia v Word Investments Limited* [2008] HCA 55

<sup>2</sup> *Commissioner of Taxation v Word Investments Ltd* [2006] FCA 1414 (3 November 2006)

significant revenue. Although clubs generate something like 20 percent of all NFP income (other than through Government grants), the demand for contributions from clubs, by various charities and sporting groups, exceeds the capacity to meet and is constantly growing.

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

### Broader than intended impact on other NFPs

In NSW, clubs were the only operators of gaming until the 1990s. A Government decision to allow private operators to enter the market should not mean that the tax benefits enjoyed by clubs at state and federal level should be removed. That would undermine the operation of all NFP businesses because their tax status could be unwound whenever a private entity enters the market. For example, using the Commission's rationale, if a private company sought to sell donated second-hand clothes, the Salvation Army and numerous other charities would lose their tax status. Such an outcome would be demonstrably unfair.

Clubs are almost certainly the most successful NFP industry at independently generating income. As explained earlier in this submission, clubs earn approximately 20 percent of all income that is independently generated by NFPs in Australia. Clubs donate money to other NFPs and it is not known how much of that might have been 'double counted' by the Australian Bureau of Statistics (ABS) as it would not be apparent through the survey that the money came from clubs as opposed to being generated from outside the NFP sector.

In addition, the amount saved by various charities and NFPs through free or subsidised use of club facilities and infrastructure would not have been counted by the ABS. Without clubs, these charities would seek subsidised facilities elsewhere, putting a strain on the Government, private sector and individuals. Many NFPs would have nowhere to meet or would compete with each other for limited space rather than focussing on fulfilling their social purposes.

If Government wants NFPs to stand on their own feet, NFPs must be allowed to compete with private business and be offered certainty that their tax status will not be altered whenever it is seen that they compete with the private sector.

**A valuation by the Commission of the national income that clubs earn, as a percentage of the Not-for-profit sector, would shed further light on the importance of clubs to the sector.**

### Significant differences between gambling operators

Even if the Commission were able to demonstrate that the tax exemptions conferred a distortionary cost advantage on clubs, this would not represent a *competitive* advantage because clubs are in many ways not direct competitors to for-profit operators. This is shown in table 1 below which highlights some of the key differences between clubs and hotels.

### Table 1 – Comparison of registered/licensed clubs with for-profit gaming operators

REGISTERED/LICENSED CLUBS	HOTELS AND ENTERTAINMENT VENUES
<b>ORGANISATIONAL STATUS</b>	
Not-for-profit organisations. Profits reinvested in services and facilities for members and in local projects that benefit the community	For profit organisations. Profits distributed to shareholders
<b>SERVICES OFFERED</b>	
Provide entertainment and gaming services predominantly for members centred on a sporting (eg. golf course, bowls) or recreational club  Scope of services is consistent with the values of the club and is much more limited than in commercial venues  Provide a range of ancillary services such as coaching, training and general support to the local community	Provide entertainment and gaming services to the general public. Wide scope of food, dining and entertainment services provided  Limited linkage to local sporting clubs or community groups
<b>COMMUNITY OBLIGATIONS</b>	
In NSW, required to allocate 1.5 per cent of gaming revenue to CDSE scheme. Similar schemes operate in other jurisdictions  Contribute extensively toward local community projects and initiatives at levels well in excess of mandatory requirements	No obligation to contribute to the community. Some jurisdictions impose levies and the minimum contribution is not typically exceeded

Table 1 shows that clubs are not direct competitors to hotels and other entertainment venues, because they effectively operate in a distinctly different industry sector by providing a different service that meets different customer needs. Thus, competitive neutrality would not be breached even if the Commission were to establish that clubs can access inputs such as labour and capital at lower cost to hotels, because clubs operate in a different industry sector to hotels.

ClubsAustralia rejects the Commission’s argument that a small regional bowling club, with few gaming machines, is in any way comparable with a city pub that has a similar number of machines.

### Case Study – Tooleybuc Sporting Club

Tooleybuc Sporting Club is located in the small rural township of Tooleybuc with a population of 275 people on the Murray River. Despite the town's size the club boasts 2883 members, many of which are drawn to the club's attractions from interstate.

The club, like hotels in the town provides hospitality services like gaming machines and food and beverage services.

However this is where the similarities cease as the club is the custodian of an extensive array of facilities, which service not only the local community but also act as a tourism drawcard for the region.

The club's main building is some 3685m<sup>2</sup> with an auditorium that seats up to 300 people. On site the club also maintains 2 bowling greens, a nine hole golf course, tennis court, 18 hole mini golf course and a basket ball court. The club also runs five 2 bedroom holiday units catering to visitors seeking a golfing getaway.

The club often provides its facilities to local organisations and sporting groups free of charge.

The local school (150 students) use the club auditorium for school functions at no cost a number of times a year. The Club also provides the local school with heavy duty lawn mowing equipment and lend their assistance in maintaining the local football grounds, cricket pitches and the local tennis courts in the town, all of which would otherwise be maintained by local government.

The club kitchen also provides weekly 'Meals on Wheels' services to those in the community unable to cook their own meals.

Over a number of years the club has also assisted various organisations establish various facilities through financial support:

- Local net ball courts \$35000;
- Koraleigh Tennis Club \$8000;
- Tooleybuc Pre-School \$40000 to assist establishment;
- assistance in establishing the local Medical centre \$15000;
- Nyah District Golf Club approx \$15000.

This small yet vibrant club clearly plays a vital role in the community's social well being with the revenue it derives from its commercial activities. If the role they currently play was to diminish it would have a clear social and economic impact on the township and surrounding region.

State and territory governments have recognised the distinction between clubs and pubs. In NSW, clubs were the only operators of poker machines from 1956 until the mid 1990s. The decision was made by the NSW Government to approve gaming in clubs alone and the decision was argued by hotels as putting them at a commercial disadvantage to clubs. Yet, this was considered acceptable on the basis that clubs were the most appropriate places to gamble and that they provided the best social dividend from money earned through gambling. The ACT still only allows gaming machines in clubs and the Canberra Casino remains barred from operating gaming. By contrast, WA only allows gaming in Burswood Casino; clubs and pubs are barred from operating gaming.

Because clubs in the ACT remain the only operators of gaming, the tax regime in that jurisdiction is irrelevant. If the ACT Government decided to allow hotels or the casino to operate gaming, but at a higher tax rate than clubs, those for-profit operators would still be significantly advantaged by comparison with their present situation.

A similar scenario exists in regard to live gambling table games. These are only approved for operation in casinos. Their approval for operation in clubs would, undoubtedly, be of significant financial benefit regardless of any special tax benefit because it would allow clubs to compete equally with casinos and offer a new source of revenue. Live table games make as much as 20 times as much money as the average club gaming machine annually. However Governments have chosen not to extend their approval outside casinos.

When gaming was first approved in NSW hotels, the value of each hotel rose dramatically. Hotels that were valued similarly to other retail businesses in the mid 1990s are now worth substantially more. Pubs are increasingly being purchased by conglomerates and multinational corporations because of their rapidly increasing value and relatively stable income.

“Monash University research shows that Woolworths has collected an estimated \$1.89 billion from Victorian poker machines since 2004... The company retained more than \$350 million in profit... The retail giant now has a 75 per cent stake in 4176 machines — almost a third of Victoria's hotel entitlements — with a substantial interest in another 1551 hotel pokies and management rights of 559 club machines. Under the banner Bruandwo, the alliance between Woolworths and Mr Mathieson paid \$1.3 billion for Australian Leisure & Hospitality Group in 2004 and established itself as the dominant player in the Victorian gaming industry.<sup>3</sup>”

This clearly shows that the differential tax treatment of clubs has not impeded the capital value or profitability of hotels. The higher tax imposed on hotels is designed to both capture some of the value that has accrued to hotel owners and recognises the social dividend attached to community based gaming. There is no reason to change these settings in the name of competitive neutrality as state and territory government policy makers have already considered the broader social and economic outcomes, not just whether an economic ideal is reached.

Australian Governments have long sought to avoid public detriment from increased competitive pressures in the gambling market<sup>4</sup>. The NSW Government completed an analysis of costs and benefits of restrictions on gaming competition to determine whether the public benefit justifies the operation of an uneven playing field.<sup>5</sup>

“The review found that the gaming machine legislation contains significant barriers to entry and other constraints on competition. The review concluded that the restrictions are considered necessary to achieve the objects of the legislation.

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<sup>3</sup>The Age, Cameron Houston, *Woolworths reaping billions from pokies in poorer suburbs*, 15 March 2009, <http://www.theage.com.au/national/woolworths-reaping-billions-from-pokies-in-poorer-suburbs-20090314-8yhr.html>

<sup>4</sup> Council of Australian Governments (2000) Communiqué 3 November 2000

<sup>5</sup> NSW Gaming and Racing, National Competition Policy, Review of the NSW Gaming Machines Act 2001 (June 2003), p22-34, <http://ncp.ncc.gov.au/docs/NSW%20Gaming%20Machine%20Act%202001,%20review.pdf>

In respect of community social standards, the review provides support for the maintenance of existing harm minimisation and responsible conduct of gambling principles (including the competition restrictions inherent in those principles) ... The review concluded that there is a net public benefit in these restrictions.

In regard to restrictions on market entry, the review concluded in favour of the continuation of a comprehensive licensing system and related entry barriers.<sup>6</sup>

Some of the benefits associated with preferential treatment for clubs were considered to be:

- Community is better served by ensuring that the majority of gaming machines are located in venues (clubs) where principles of mutuality and co-operation apply;
- Gaming machine profits from the club sector more likely to be returned to the community, due to the not-for-profit nature of clubs;
- Higher spend levels by hotel gamblers are addressed; and
- Gambling levels are lower than would be the case if hotels had the same cap as clubs.<sup>7</sup>

**ClubsAustralia submits that Government needs to consider broad issues of public benefit, not just competitive neutrality, when setting policies in relation to gambling – including tax rates.**

### Cost-benefit analysis of clubs

More broadly, the Commission appears to raise concerns about whether the tax-exemptions provided to clubs are in the interests of the community. The draft report states that the contribution of clubs made to the community via the CDSE scheme and other contributions are an insufficient basis for the tax exemptions they receive. For example, the Commission states that:

*“The fact that clubs provide donations and other support to the community in general is not a prima facie argument for providing clubs with substantial tax concessions in relation to gaming revenue.”*

Given that the Commission does not appear to have adequately established an underlying economic rationale related to competitive neutrality for substantially changing club tax arrangements, any decision to remove these exemptions would be a policy matter for elected governments. On this point it is important to note the significant social infrastructure that clubs provide and specialist skills in the delivery of charitable services. Increasing the tax burden on clubs, could lead to a loss of some clubs and therefore a loss of critical social infrastructure and skills which could, in turn, result in a less efficient outcome from the expenditure of each charity dollar.

Any change in government policy toward clubs would need close and careful consideration given the impressive contribution they make to the community. For example, a recent reports prepared for ClubsNSW found that clubs in NSW make the following contribution to the NSW economy and community:

- The industry employs approximately 43,000 NSW residents, generates \$1.3 billion per annum in direct wages which flow into the NSW economy and undertakes capital investment of approximately \$858 million per annum;

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<sup>6</sup> Ibid. Executive Summary, page ii

<sup>7</sup> Ibid. p29

- In addition, the NSW registered club industry consistently contributes far greater amounts to the community than is mandated under the CDSE scheme. For example, in 2008, clubs contributed \$62.6 million in CDSE payments (cash and in-kind), some \$26.6 million greater than was required. IPART also acknowledged that clubs do not report the full extent of their social contributions and, therefore, CDSE could be considered conservative; and
- IPART estimated that in 2007, the NSW registered club industry made an \$811 million direct social contribution to NSW. IPART further commented that “the registered club industry’s net social contribution is positive. On this basis IPART considers it appropriate for the NSW Government to provide support to the industry, to help ensure the industry’s viability so clubs can contribute to positive social outcomes in the State”<sup>8</sup>.

Even this figure of the NSW club social contribution can be viewed as an underestimation.

As the Productivity Commission noted:

Many studies of the effects of social capital have found that their social capital indicators are positively related to a range of beneficial social and economic outcomes. However, because social capital as a concept is relatively new, multifaceted and imprecise, measuring social capital and its effects is extremely difficult. Many of the indicators that researchers have used to gauge social capital are open to criticism.<sup>9</sup> (XIII)

The conclusion that clubs receive tax concessions relative to hotels cannot be considered in isolation and any comparison must have regard to the different roles played by clubs and hotels in the provision and support of social infrastructure. Clubs Australia believes that a proper comparison should take into account more than just tax rates when attempting to assign dollar values to clubs and hotels.

Clubs give far more in donations/social contribution (as measured by the NSW Independent Pricing and Regulatory Tribunal (IPART)) than is achieved through the various tax benefits received by clubs. 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 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 and dramatically outweighs the value of gaming tax benefits calculated by the Commission in the draft report (at 7.10) as being \$724 million per year.

In other words, clubs conservatively contribute to the community nearly double the value of the gaming tax concession that is received by clubs. The value for taxpayer dollar receives a strong multiplier effect, even before the higher costs associated with gambling impacts from hotels are addressed.

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<sup>8</sup> IPART, *Review of the Registered Clubs Industry in NSW*, 2008

<sup>9</sup> Productivity Commission, *Social Capital: Reviewing the Concept and its Policy Implications*, 2003, p XIII

**A valuation by the Commission of the annual social contribution made by clubs nationally would indicate the extent to which clubs are different to private operators.**

### Tax Rates – Clubs v Hotels (NSW example)

In terms of taxation rates it is important to note the revenue distribution across the various bands in clubs and hotels and the rate of taxation applicable to that revenue. Table 2 shows the percentage of total gaming machine revenue in the top three club and hotel bands and the tax rate that is applied to that revenue. Less than 2% of hotel revenue is taxed at the top marginal rate, while 13% of club tax is paid at the top rate of 39.99%. ClubsAustralia suggests that while the hotel top marginal rate of 53.09% appears high, the reality is that it applies to an extremely small proportion of the overall hotel gaming revenue. Approximately 40 percent of hotel gaming machine revenue is taxed at the 2<sup>nd</sup> top marginal rate of 42.89%. In the case of clubs, just over 43% of the revenue is taxed at the top three marginal rates.

This shows that any comparison that focuses only on the top hotel marginal rate against the top club rate is not appropriate, nor is an analysis which simply averages the rates. Comparison of hotel tax rates with clubs must account for the relative revenue distributions.

**Table 2 – Comparison of Top Club and Hotel Gaming Machine Revenue Bands and Marginal Tax Rates (NSW)**

Club Revenue Band	Band Tax Rate (Includes GST&CDSE)	Percent of Total Club Revenue taxable at band rate <sup>c</sup>	Hotel Revenue Band	Band Tax Rate (Includes GST)	Percent of Total Hotel Revenue taxable at band rate <sup>c</sup>
\$5million to \$10million	35.09%	16.2%	\$400k to \$1million	37.89% <sup>a</sup> (39.09% <sup>b</sup> )	25%
\$10million to \$20 million	38.09%	14.4%	\$1million to \$5million	42.89% <sup>a</sup> (44.09% <sup>b</sup> )	41%
\$20 million plus	39.99%	13.0%	\$5 million plus	53.09% <sup>a</sup> (59.09% <sup>b</sup> )	< 2%

Notes: a) rate from 1 July 2008.

b) rate from 1 July 2010.

c) calculations are based on OLGR Quarterly gaming data year end February 2008 for clubs and March 2008 for hotels.

The hotel revenue distribution and the applicable tax rates shown in Table 2 suggests there is a strong case that “above-normal” profits in clubs are subject to disproportionately higher tax than hotels when the full extent of community sharing in gaming profits is considered, that is, the \$811 million social contribution of NSW clubs is considered.

## Will competition improve by removing the tax differential?

The Commission makes the assumption, by pushing the competitive neutrality line in regard to tax, that tax is the only area which distinguishes clubs from private operators and by removing the tax differential that all venues will compete equally. In fact clubs and private operators are markedly different and should not be expected to compete on an even playing field.

As NFPs, clubs are managed by volunteer boards of directors and are required to fulfil their social purposes under their constitutions. They are not as capable as private operators, whose sole object is the creation of wealth, at responding to the market. Clubs also have a very different perception of their patrons, who as members effectively 'own' the club, as opposed to private operators.

These differences can be seen in both the higher spend on privately owned gaming machines and the higher value placed on hotel gaming machine licences. While a club gaming machine entitlement in NSW is valued at approximately \$20,000 the price for a hotel gaming machine entitlement is approximately \$150,000. The amount earned per hotel and casino gaming machine is also far higher than that earned by an average club gaming machine.

As explained previously, the value of hotels has increased dramatically since their approval for the operation of gaming. If clubs had their tax regime wound back, were forced to close or were less able to compete, the value of hotels would rise further. It is not apparent that publicans are 'struggling', such that further increases in the capital value of hotels, at the expense of not-for-profit clubs, is warranted.

## Tax Rates – Clubs v Casinos

Casinos in most jurisdictions have lower gaming tax and less gaming restrictions than clubs, therefore the argument implied by the Commission that clubs have an unfair competitive advantage against all private operators is untrue. The differential is only over one class of private operator. Table 3 shows the tax rate that applies to Star City Casino in NSW under the terms of its licence agreement with the NSW Government.

**Table 3 – NSW Casino State Tax Rate (excl. GST and Responsible Gambling Fund)**

Year	Rate
2009-10	13.41%
2010-11	14.41%
2011-12	15.41%
2012-13	16.41%
2013-14	16.41%

The extent of the casino's tax concession, relative to large clubs, should not be underestimated. By way of example, the annual casino gaming revenue (tables and poker machines) in 2007 was around

\$580 million. Applying the 2008-09 rates this would result in tax of \$ 140 million (includes GST & RGF). The largest 12 clubs generate around \$580 million in annual gaming machine revenue. These clubs pay a total tax of approximately \$219 million (including GST and CDSE) on this amount of revenue. If the casino was taxed at the same level as the largest clubs this would generate approximately \$80 million annually of additional state tax revenue. In our view the casino receives a significant annual tax advantage over large clubs which over a 12 year period will far exceed the \$100 million one off upfront exclusivity payment.

Current tax rates for interactive gambling, wagering, lotteries and other forms of gambling are also dramatically lower than is paid by clubs. Therefore if it were recommended that competitive neutrality principles be implemented in regard to clubs, the application of a neutral playing field to all gaming participants would have broad ramifications and perhaps, unintended consequences of altering player and commercial activity.

**ClubsAustralia submits that the Commission has selectively considered the issue of competitive neutrality, neglecting comparison with gambling providers other than hotels.**

### Operation of s50-45 of the ITAA

For clubs whose main purpose is the encouragement of sport, the existence of section 50-45 of the ITAA (Income Tax Assessment Act) provides them with tax exemption to support a range of sporting activities, from construction and maintenance of sporting fields to direct and in-kind support for sporting teams of all grades. This activity by clubs alleviates Governments of the need to allocate the significant sums of money required, encourages volunteerism through clubs, ensures support is realised locally throughout the country and, through increased sporting participation helps reduce the incidence of obesity. Governments of all persuasions have recognised the benefits that have flowed to the Australian community through Olympic, professional and amateur sporting achievement that would never have occurred but for the opportunities provided by not-for-profit sporting clubs.

The operation of the ATO's assessment of the eligibility for clubs to receive tax exemption under section 50-45 of the ITAA is vastly different to that reported by the Commission in the draft report. The Commission reported that clubs are able, through the tax benefits they receive, to invest in shopping centres and supermarkets. This is not the case.

ClubsAustralia estimates that approximately two-thirds of our member clubs receive tax exemption under section 50-45 of the ITAA. In order to be eligible the club must, in each financial year, fulfil its main purpose which is the encouragement of sport. Proving eligibility to the ATO is not easy. There is a rigorous system of Private Binding Rulings and legal precedent, with each club assessed on its merits.

A careful assessment is needed to be undertaken in regard to all of a club's activities, including non-sporting, before a decision can be made whether 'encouraging sport' is the club's main purpose. A club which sought to pursue large, non-sporting investments would face a challenge to prove that its main purpose remained the encouragement of sport. For those clubs that are not eligible for the exemption, the principle of mutuality provides tax relief on certain income from club members.

## 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*.

Clubs are subject to full taxation 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. Full tax is paid on non-member income.

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.

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.

The then Federal 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. It is important to note that the amendment had the support of the then Opposition, now in Government. Clearly mutuality is considered important.

**ClubsAustralia submits that the principle of mutuality is firmly grounded, supported by Government and should be maintained.**

### Consequences of Increased Taxation

Most clubs would respond to a significant tax increase by adjusting their outgoings, such as donations and capital expenditure, laying off employees and increasing the prices of non-gaming products, such as food and drink. The real negative impact would be on 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 it would be highly deleterious to club viability, as well as the communities and jobs they support, to increase taxation on clubs.

In 2008, KPMG measured the impact on clubs and the NSW economy of the 2004 gaming tax increases and modelled the impact into the future if the rates remained at the existing level. They found that by 2012:

- Clubs of all size are forecast to be below the 15% EBITDARD threshold for financial distress;
- There will be at least 190 club closures;
- The annual social contribution made by NSW clubs will decline by \$219 to \$343 million; and
- By 2014 the combined decline in trading performance and the decline in capital investment will result in:
  - An average of 3,912 jobs lost in the NSW economy annually;
  - An average of 391 jobs lost in clubs annually; and
  - A decline of \$1.6 billion in Gross State Product (GSP) in net present value terms.

### Comparative Advantage of Club Community Support

The Commission suggests that reduced community support by clubs due to higher taxation would be of little consequence. Governments are better able to decide centrally through the increased taxation what should be the priorities for communities. As the draft report states:

‘While Clubs Australia shows that its members have used funds for community purposes, it has also not demonstrated that clubs have a comparative advantage over Governments (or individuals) in allocating resources for community needs’. (8.26)

ClubsAustralia is of the belief that the current system provides a balance between local priorities and Government priorities. Localised support has many advantages. It allows for timely responses which are often necessary. It allows for the efficient distribution of funds locally which would not be have been provided if left to Government or individuals.

### **Case Study - Bankstown City Aged Care**

The organisation is a Public Benevolent Institution created in 1972 to service the frail and aged living in Bankstown Local Government Area. This is an area of approximately 160,000 citizens, it has a lower income level than the Australian average, higher aged percentage of the total population than the Australian average and more than 50% of the population have one parent overseas born or speak a language other than English at home.

The organisation is unique in that it is the only aged care charity in Australia whose membership comprises the State Government (in the form of local hospitals, Bankstown and Lidcombe), local Government (Bankstown City Council), two of the largest registered clubs in Australia (Bankstown Sports and Revesby Workers), Bankstown Trotting Recreational Club, five of the six RSLs in the community (Bankstown, Bass Hill, Chester Hill/Carramar, Panania Diggers and Revesby Heights Ex-Servicemen's Memorial Club), the three Lions Clubs in the area (Bankstown, Greenacre and Yagoona) and Bankstown Rotary club.

Since 1972 the organisation has grown to employ over 250 people, the majority of whom are from non English speaking backgrounds, looking after 600 clients, 350 in residential care (comprising low care, high care and dementia specific care), 200 clients at home (Community Aged Care Packages and Veterans Home Care) and 50 clients on a daily basis through a dementia day care centre.

Since 1990 they have received no capital subsidies from the Commonwealth Government to maintain or upgrade their facilities.

In spite of this, Bankstown Aged Care is currently building a new 3 storey, 60 bed unit and refurbishing 46 of their original beds built at Revesby. This will provide a state of the art 106 bed unit which will arguably be the best aged care facility in the Local Government Area. It has been part funded by the registered clubs and borrowings from the bank. There have been no direct Government capital grants whatsoever for this project – local, state or federal.

This is despite Australia's ageing population, identified by the Commonwealth Government as a pressing concern. The needs of our ageing population must be met. In the absence of direct Government support, clubs in areas like Bankstown are meeting the need.

This project, including the purchase of the land, will cost around \$17m. It is stage one of a massive three stage development on the site. Eventually the site will accommodate up to an additional 200 clients on a residential or home based services model.

In characterising the importance of the club contribution to the project Bankstown Aged Care CEO, Terry Madden observed:

'The value of registered clubs to our organisation cannot be over estimated. Without their financial support and the support of their Directors (who are normally the members nominated by their organisations to stand for election to our Board) we would not function. Ever since we started the Government has never funded our building program at an amount sufficient for us to build a quality building fabric'.

## Club Funding Models

### NSW Club Support

While the Commission believes that club funding decisions are made by clubs, Community Development Scheme (CDSE) funding decisions in NSW are driven predominantly by community need. Local Government Areas with CDSE category 1 liabilities of over \$30,000 must have a local committee in place. The committee includes representatives from the Department of Community Services (DOCS), the Council of Social Services (NCOSS), the local council and local Indigenous groups (if available).

Through this tailored approach, local committees advise clubs on appropriate spending and areas of need in the community. Part of the strengths of the local committee system is that clubs are offered a different funding perspective to their traditional recipients.

Under the ClubsNSW code of practice clubs give community support in accordance with the clubs purpose as well as the needs of the community. For example, clubs in coastal areas sponsor life saving and rescue associations and RSLs sponsor causes like Legacy and meals on wheels.

In making a submission to the Productivity Commission's current inquiry into gambling NSW State Member for the Murray-Darling, John Williams MP, detailed the unique importance of this support in his own vast rural electorate.

'In the smaller communities the Club is sometimes the only facility that meets the social need of the township and the wider area. The Club in most cases is the only structure large enough to provide for one-off occasions, forums or information sessions.

The Clubs provide catering, in some cases the only place to provide a meal. The Clubs in these smaller communities financially support sporting and cultural activities, build infrastructure in most cases not reflecting the purpose of the Club, but something that is needed by the community. In actual fact these Clubs fill the funding void between Local, State and Federal government'.<sup>10</sup>

Clubs are well placed to fund local activities and community groups. For instance applying for club funding under CSDE is relatively fast and easy in comparison to government funding programs. This is especially the case as Club funding is available all year around and is processed locally.

As the Federal Member for Kingston, Peter Garrett AM, observed when making a submission to the Commission's inquiry into gambling in support of the South Sydney Graphic Arts Club in his electorate.

'I have always been impressed with the club's support of the local community, particularly in the area of arts and education. The club regularly inputs to local school communities with a mixture of in-kind and cash donations'.<sup>11</sup>

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<sup>10</sup> Submission 209, Productivity Commission Gambling Inquiry 2009

<sup>11</sup> Submission 42, Productivity Commission Gambling Inquiry, 2009

The funding framework is local and groups who seek funding can easily contact and speak to their local clubs or local CDSE committee representatives. The application process for community groups is simpler than government applications. For amounts under \$500 a letter requesting funds and a thank you note or receipt is sufficient. Clubs provide funds first and claim the funding as CDSE at the end of the tax year.

### **ACT Club Support**

Clubs provide for the diverse social and recreational needs of a broad cross section of the Canberra community - and importantly families and seniors - they cover sporting, social, cultural, ethnic, worker, professional and returned services interests. However, the most important contribution that clubs make is their presence, their daily interaction and their connection with the ACT community.

This has prompted the ACT Chief Minister, Jon Stanhope, to say that *“clubs are a unique feature of Canberra life worth preserving and encouraging”*. He has also said that *“we are not a “pub” town but a “club” town. Some people fail to recognise that distinction. I do not. My Government does not.”*

Collectively, Canberra's clubs contributed \$14.6 million in 2007/08 to a large number of charitable, sporting and community organisations (an increase of \$1.8 million over the previous year, despite a reduction in gaming income from \$185 million to \$177.3 million)

- This is \$7.6 million more than the amount required under the legislation or more than double the mandated 7% of Net Gaming Machine Revenue; and
- Over the past 11 years, the level of community contribution has averaged 12.3% per year, bringing the total contribution to eligible community recipients to almost \$140 million over that period.

There is no statutory contribution requirement on hotels and taverns in the ACT – in contrast to the club sector, in 2007/08 their contribution dropped from \$73,000 to \$52,000. A major initiative that ClubsACT introduced in late 2001 has been the pooling of contributions from a group of Member Clubs, to provide significant financial support to a number of worthy local organisations which service the Canberra community.

These significant headline numbers really understate the extent of the contribution that individual clubs make which, as well as cash contributions, includes in-kind support and, in many cases, involvement with the recipient.

### **Localised decision making**

ClubsAustralia recognises that a centralised Government perspective is necessary for deciding cross regional priorities. But it also realises that this perspective has inherent weaknesses. Government priorities are determined by several factors which include non-community need drivers such as political considerations. It can mean that more politically marginal areas can receive benefits at the expense of communities in other areas providing the taxes.

Club members are a part of the local community and reflect the values and understand the issues of their community. Their boards are elected democratically. Their boards reflect the wishes of the membership in providing in-kind support and monetary donations to groups and individuals in their community.

Australia's three tiers of government make centralisation of spending and priority setting a complex and cumbersome task. At present many of the community support activities provided by clubs are local government issues. However the flow of funds suggested by increased taxation will be either to federal or state governments. This system makes it very difficult to be confident that new priorities would yield better results than the current settings.

It is certain, however, that there will be a loss of community funds through centralisation. Administration and compliance costs for taxation collection can significantly reduce the size of funds available for distribution by governments. Administration of the funds over three tiers of government would also mean a loss of available funds for community support.

**ClubsAustralia submits that clubs deliver services to the community in a faster, less bureaucratic, more long-term and better tailored way to meet local needs than Governments or individuals are capable of.**

### **Governance regulation**

As noted in ClubsAustralia's initial submission clubs are already sufficiently regulated. The current governance framework that clubs have to contend with in fulfilling their purpose should be taken into account before any move to alter the regulatory landscape they operate within is considered. In particular, ClubsAustralia would not support any additional compliance or regulatory framework for not-for-profits be applied to clubs, unless existing requirements are eased.

If duplication could be avoided, ClubsAustralia would support clubs having the option to be under the Productivity Commission's recommended national incorporation registrar.

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