

## INCOME TAX – CLUBS AND OTHER NFP'S

### (Draft Income Tax Ruling TR 2014/D5)

Readers may recall that in June 2013, the then Labour Federal Government passed the Tax Laws Amendment (2013 Measures No. 2) Act 2013 which carried on the title page “*An Act to amend the law relating to taxation and the Tax Agent Services Act 2009 and for other purposes.*”

Schedule 11, headed “*Miscellaneous amendments*” imposed, amongst many other amendments, to the Income Tax Assessment Act 1997 (ITAA 1997) two additional special conditions for clubs to satisfy in order to achieve income tax exemption pursuant to Sec 50.45 Item 9.1. The legislation was introduced with little fanfare and no general consultation, much to the concern of many NFP advisers. However, of greater concern was the potential for the special conditions to be interpreted narrowly and to the detriment of clubs.

To briefly recap, all the ordinary income and statutory income of a society, association or club that is established for the encouragement of animal racing, art, a game or sport, literature or music is exempt from income tax (Sec 50.45 Item 9.1, ITAA 1997) if it satisfies the conditions in Sec 50.70.

Sec 50.70(1) remains the same requiring a club to be “*not carried on for the purpose of profit or gain of its individual members*” and to have a physical presence in Australia and to pursue its objectives principally in Australia.

Sec 50.70(2) of ITAA 1997 introduces two additional tests which are discussed below in Draft Ruling TR 2014/D5. The Draft Ruling seeks to offer the view of the Australian Taxation Office (ATO) on the interpretation of the two additional tests. We have been advised by the ATO that to assist clubs to determine their predominant purpose “*Taxation Ruling TR 97/22 Income Tax: exempt sporting clubs*” has not been displaced, and therefore will continue to be the ATO’s formal view.

Whilst TR 97/22 is stated only as applying to sporting clubs we understand that the ATO applies the same principles to any club, society or association listed in Sec 50.45 Item 9.1.

## **TWO ADDITIONAL REQUIREMENTS FOR CLUBS TO ELIGIBLE FOR INCOME TAX EXEMPTION**

The Draft Public Ruling TR 2014/D5 issued on 13 August 2014 and offers the ATO's view on the two additional Special Conditions.

The new Special Conditions mean that, in addition to the existing requirements for exemption, Clubs must satisfy two further requirements:

1. A Club must comply with all the substantive requirements in the Club's governing rules ("the Governing Rules Condition"); and
2. A Club must apply its income and assets solely for the purpose for which the Club was established. (the "Income and Assets Condition")

Note:

While the second Condition refers to "purpose" the Draft Ruling indicates that this word can be read as referring to "purposes".

In this context "purpose for which the Club was established" is to be taken to mean the objects of the Club in that particular year.

A failure to meet the requirements of either Special Condition would disqualify a Club from exempt status in the year that the failure occurs. However, while not part of the binding section of the Ruling, it is indicated that the Commissioner may apply a discretion if the Club takes remedial action to correct the breach.

### **1. The Governing Rules Condition.**

The Draft Ruling explains that the substantive rules are those which define the rights and duties of the Club such as those that give effect to the purposes of the Club, relate to non-profit status, the winding up of the Club and financial reporting. A breach of such requirements would make the Club ineligible for exemption in the year of the failure.

These are contrasted to procedural rules. Examples of procedural breaches would be non compliance with liquor licensing laws, rules requiring committee approval for certain expenditure, rules relating to notice of meetings. A failure to meet such procedural requirements would not result in a breach of the Governing Rules Condition.

## **2. The Income and Assets Condition.**

The Draft Ruling indicates that a Club which uses its income and assets in furtherance of its sporting and its social/entertainment purposes each year will satisfy this Condition. A Club which determines to accumulate funds in a particular year pursuant to a plan to use the income or assets in a later year to further its objects would probably satisfy the Income and Assets Condition.

A Club which uses its income or assets for purposes not specified in its objects or for the private benefit of its members may fail this requirement and would be ineligible for exemption in the year of that failure. Insignificant inadvertent misapplications may not constitute a breach of this requirement.

### **Conclusion.**

In the legislation the Special Conditions are expressed narrowly in relation to clubs but the Ruling proposes a more liberal interpretation of the requirements. How these requirements are administered in practice will have to be closely monitored.

The Draft Ruling invites submissions from interested parties by 26 September 2014.

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