

Alpine Update

June 2011

Ski Clubs, Taxation and the Associations Incorporations Act

The majority of ski clubs in Victoria's Alpine Region are incorporated associations under the *Associations Incorporation Act 1981* (Vic) ("AI Act"). The remaining minority are companies limited by guarantee or shares, co-operatives or trusts.

Traditionally, most ski clubs were predominately or even exclusively used by members and their guests. However, more recently, to remain financially viable, many ski clubs are, or are contemplating, advertising accommodation to the public through internal or external websites and booking agencies.

This article discusses aspects of income tax legislation applicable to ski clubs and their trading activities and some other relevant taxation considerations.

1. Incorporated Associations Current Prohibition on Trading

Section 51(1) of the AI Act currently provides that an incorporated association must not:

- (a) trade;
- (b) secure pecuniary profit for its members; or
- (c) as a trustee, trade or secure pecuniary profit for persons who are members of the incorporated association.

The restriction on trade prevents incorporated associations from conducting 'substantial' or 'significant' trade. Permitted activities include:

- (a) trading freely with members; and
- (b) incidental trading activities (not substantial when compared with other activities).

This restriction on trading means ski clubs which are incorporated associations could be in breach of the AI Act in advertising and providing accommodation through external booking agencies. The penalty for breaching the trading restriction is 60 penalty units (\$7,167).

2. Amendments to the *Associations Incorporation Act 1981*

On the 24 August 2010, the *Associations Incorporation Amendment Act 2010* ("the Amending Act") received Royal Assent. The Amending Act along with the *Associations Incorporation Amendment Act 2009*, will result in extensive reform of the AI Act. The Amending Act will come into effect on a date to be proclaimed, or if not proclaimed before, 1 December 2011.

One of the major amendments introduced by the Amending Act is the removal of the prohibition on trading activities referred to in 1 above. The prohibition on securing pecuniary profit for its members and the prohibition on doing any act that is outside the scope of the purposes of the association remains¹.

Under the AI Act an incorporated association's purposes have to be set out in its 'statement of purpose'. Under the Amending Act, the requirement for a statement of purpose is repealed; instead the rules must now state the association's purpose.

The duties of members of a committee of an incorporated association have been clarified under the Amending Act, and to a large extent are modelled on those under the *Corporations Act 2001* ("Corporations Act").

¹If an incorporated association acts outside its objectives the acts may be invalid by reason of them being beyond power (*ultra vires*). The common law doctrine of *ultra vires* is modified by section 17 of the AI Act which preserves the contractual liability to third parties even if the entity acted beyond power or engaged in a prohibited transaction. However under section 14A of the AI Act recourse for the conduct is available to members, the association or the Registrar through an application to the Magistrates' Court.

3. Alternative Structures for Ski Clubs

Companies limited by guarantee are not prohibited from trading under the Corporations Act, so long as they operate on a not-for-profit basis. So ski clubs which are companies limited by guarantee can trade with members of the public in providing accommodation and other services so long as they remain not-for-profit entities.

4. Income Tax Exemption

4.1 Generally

A ski club will not be exempt from tax unless:

- (a) it is a society, association or club established for the encouragement of a game or sport;
- (b) it is not carried on for the purpose of profit or gain of its individual members; and
- (c) it has a physical presence in Australia.²

While there is no requirement for a not-for-profit entity to seek confirmation that it is exempt from tax from the Australian Taxation Office ("ATO"), audits can be conducted at any time by the ATO. Therefore it is important for a ski club which believes it is exempt from tax to ensure it is able to satisfy the requirements under the *Income Tax Assessment Act 1997* ("ITA Act").

4.2 A society, association or club established for the "encouragement of a game or sport"

Snow sports are accepted by the ATO as a 'game or sport' [see paragraph 38 of ATO Tax Ruling 97/22]. All ski clubs should ensure that their constituent documents include, preferably as their main objective, the 'encouragement of snow sports'. However, while persuasive, ATO rulings and case law show that a statement of the main purpose in an entity's constituent documents is not sufficient to satisfy the exemption: *St Mary's Rugby League Club Ltd v The Commissioner of Taxation* (1997) 36 ATR 281 ("St Mary's").

Most, if not all, ski clubs provide accommodation services on or near a ski resort to members and guests. Case U128 87 ATC 853 dealt with the question of whether a ski club was established for the encouragement of a game or sport under the previous income tax legislation (although the exemption was effectively the same). In that case the Commissioner contended that the main objective of the club was not to promote skiing but to provide accommodation for reward to members and their guests and friends. The Administrative Appeals Tribunal ("the Tribunal") rejected this argument holding that the real purpose of the club was to provide, furnish

and maintain a ski lodge with attendant facilities like drying rooms so as to enable members to participate in the sport of skiing. The Tribunal noted that "[j]ust as change rooms might be considered to be essential to a football team so was the lodge vital for members of the [ski club]."

A determination of the purpose for which a ski club is "established" will be a matter of fact and degree. Factors that may be relevant in determining eligibility for the exemption could include:

- (a) resolutions of the committee;
- (b) minutes of meetings;
- (c) the club's business plans;
- (d) promotional material about the club's activities; and
- (e) published reports about the club, like its annual report.

Social activities not directly related to the encouragement of snow sports may raise questions about a club's eligibility for the tax exemption. Those activities commonly may include:

- provision of accommodation outside the ski season; and
- provision of restaurant and bar facilities.

In *Cronulla-Sutherland Leagues Club Ltd v Federal Commissioner of Taxation* (1990) 23 FCR 82 ("Cronulla-Sutherland") at 95 Lockhart J stated a club "may have other objects or purposes which are merely incidental or ancillary thereto or which are secondary and even unrelated to the main purpose without disqualifying...[the club]...from the exemption."

In both *Cronulla-Sutherland* and *St Mary's* the clubs argued they had as their main purpose the encouragement of rugby league. *Cronulla-Sutherland's* constituent documents provided that its objectives included the promotion of social sporting and educational activities for members and to provide the facilities necessary to further the aims of two local league clubs. While *Cronulla-Sutherland* provided most of the income for the local football clubs, it also conducted extensive social facilities including other sporting facilities, restaurant, bar and pokies facilities. *St Mary's* constituent documents provided for the management and promotion of rugby league in the district, assisting rugby league clubs and providing clubhouse and playing facilities to members. As well as fielding numerous rugby league teams, it also provided significant social facilities to members including restaurant, pokies and bar facilities.

A fundamental question for ski clubs is at what point do secondary purposes or activities become either co-ordinate to the encouragement of skiing or in themselves become the main purpose?

² Section 50-70 of the *Income Tax Assessment Act 1997*

In establishing the main purposes of a non-profit entity the Australian Taxation Office Ruling TR 97/22 indicates that persuasive features include:

Highly Persuasive	Moderately Persuasive
the club conducts activities in the relevant year that directly relate to the game or sport;	The level of participation by members in the sport encouraged;
sporting activities encouraged by the club are extensive;	whether the running and control of the club indicates sport encouragement is a purpose;
the club uses a significant proportion of its surplus funds in encouraging the game or sport; and	advertising and promotion of the sport is encouraged;
the club's constituent documents emphasise that the club's main purpose is to encourage a game or sport.	proximity to sporting facilities; and decoration and fit out of club so as to reflect sporting nature.

A comparison of the decisions in Cronulla-Sutherland and St Mary's shows that there is no one single determinative factor in deciding whether or not a particular entity has as its main purpose the encouragement of a game or sport. St Mary's shows that mere engagement in significant social activities does not preclude exemption. The Commissioner argued that the extensive social activities undertaken by the clubs, which included the provision of poker machines, restaurants, bars and entertainment facilities, were in fact the main purpose and therefore the Clubs were not entitled to the tax exemption.

In both Cronulla-Sutherland and St Mary's the Federal Court looked at the '*constitution, activities, history and control*' of the clubs. It was in both cases found that the club:

- had constituent documents which provided for the support and/or encouragement of rugby league as a purpose;
- were controlled by persons that either participate in or are avid supporters of rugby league; and
- provided some financial support to the game of rugby league, although the majority went into the provision of the social activities.

However, the Federal Court made alternate findings in Cronulla-Sutherland and St Mary's as to exemption on the facts. The club in St Mary's was found to be exempt, while the club in Cronulla-Sutherland was found not to be exempt. The Federal Court noted the following were distinguishing features in St Mary's:

- there were two clubs in the Cronulla-Sutherland area, one was devoted to the pursuit of football while the other (the appellant in this case) was a club which assisted in financing the football club (although it should be noted the assistance was to the extent that the football club would not be able to exist without the grants);
- the Cronulla-Sutherland club did not itself organise any competitive football;
- the membership structure in the St Mary's club gave emphasis and importance to present or previous footballers or supporters; and
- the size and intensity of the social activities in the Cronulla-Sutherland club was of greater significance.

The distinction between the two cases was in the analysis of the clubs' direct participation in the sport and their structure; although financial support of the sport using surplus funds was relevant as '*the potential of [a club] to apply its surplus funds for purposes having nothing to do with the encouragement or promotion of [a sport or game] is a significant matter*' (Lockhart J in Cronulla-Sutherland). The Cronulla-Sutherland club was not exempt because the social activities had become an end in themselves instead of a means of financing the sporting activities of the club.

The Cronulla-Sutherland decision shows it is not sufficient to just look at the purpose of the club at the time of its formation. The ITA Act requires the inquiry to be focused on the activities and purposes of the club for the relevant taxation years.

We believe ski clubs can argue that providing accommodation to non-members or guests outside the ski season is to earn money to enable the club to pay its expenses of providing accommodation in the ski season to enable persons to ski. The summer trading activities are likely to only be a lesser part of a ski club's annual income. Further, to demonstrate the 'encouragement', ski clubs should also attempt to promote or organise participation in occasional snow sports events (intra or inter club) or the provision of snow sports equipment at the club. However, if bar/restaurant facilities or the like are provided, and it could be suggested that those activities in themselves become the major purpose of the club, then a ski club may not be exempt from tax.

4.3 Not for Profit Requirement

To satisfy this requirement generally a club's constitution or other constituent documents should contain a prohibition against a distribution of profits and assets among members while the club functions and on its winding up. Alternatively, this requirement is satisfied if the law governing its activities prevents the club from making distributions to members. And the club's actions must be consistent with the policy and/or law.

For incorporated associations, Section 51(1) of the AI Act explicitly prohibits the securing of pecuniary profit for its members and section 36CA generally prohibits distributions to members upon winding up. Section 254SA of the Corporations Act also prevents companies limited by guarantee distributing dividends to members; however there is no legislative restriction on distributions to members upon winding up.

Incorporated associations will satisfy the not-for-profit requirement due to their governing legislation. However, companies limited by guarantee should have constituent documents preventing distribution of profit or assets on its winding up to their members, and co-operatives also should have constituent documents preventing distribution of profit or assets to their members while the club functions and on its winding up.

Examples of suitable clauses in constituent documents, as provided by TR 97/22 are:

Not-for-profit clause:

The assets and income of the organisation shall be applied solely in furtherance of its above mentioned objects and no portion shall be distributed directly or indirectly to the members of the organisation except as bona fide compensation for services rendered or expenses incurred on behalf of the organisation.



Dissolution clause:

In the event of the organisation being dissolved, the amount that remains after such dissolution and the satisfaction of all debts and liabilities shall be transferred to any organisation that is carried on predominantly for the encouragement of a game or sport and is not carried on for the profit or gain of its individual members.

If neither the law governing the entity nor the constituent documents restrict distribution of profits, TR 97/22 provides that it becomes a question of fact in each case in determining whether the club is not-for-profit. The ruling provides that factors which will tend to establish the entity as being not for profit include:

- (a) whether distributions have been made;
- (b) whether there is a stated or demonstrated policy to make or not to make distributions;
- (c) whether it is clear from the objects, history, activity and proposed future directions of the club that there will be no distributions.

5. Land Tax Exemption

Section 9(1)(g) of the *Land Tax Act 1958* ("LTA") exempts from land tax land which is "vested in a body corporate or unincorporate... that exists for the purpose of providing or promoting cultural or sporting recreation or similar facilities or objectives and that applies its profits in promoting its objectives and prohibits the payment of any dividends to members."

At first glance, this exemption seems to be similar in nature to the section 50-70 ITA Act income tax exemption discussed above. A recent decision of the Supreme Court of Victoria has held this to be true, finding that if a body corporate or unincorporate meets the income tax exemption under section 50-70 it will also meet the section 9(1) land tax exemption. In *Commissioner of State Revenue v Bogong Ski Club Inc 2000* ATC 4805 Justice Hansen found that the 50-70 exemption 'is at least co-extensive with what is required to qualify for the exemption in s.9(1)'.

Ski clubs which claim the income tax exemption, but currently pay land tax should seek further advice as to whether they may be able to claim the benefit of this exemption.

6. Mutuality Principle

The mutuality principle is a legal principle established by case law and prevents the income derived from an entity's members (i.e. membership fees, etc.) being characterised as 'income', so these monies are not assessable for the purposes of the ITA Act (ATO Taxation Guide - NAT 73436). The reasoning behind this principle is that the money received comes from the entity itself. The Federal Court in Cronulla-Sutherland said '*the club's 'income' contemplated by this section is not the whole of the net revenue of the club but simply that part of it which falls outside the operation of the principle of mutuality.*' The effect is that the income tax exemption discussed above does not need to be considered for club income that falls within the mutuality principle.

In NSW many licensed sporting clubs, to claim the income tax exemption, have adopted the concept of a 'notional temporary membership' category for non-members/unaccompanied guests. Some ski clubs have also adopted this approach to manage their summer bookings for bushwalking and cycling groups. Where this methodology has been put into practice non-members and unaccompanied guests pay a nominal fee when making a booking which provides them with temporary memberships (but no other rights). The adoption of these processes to ensure all income of a ski club is provided by or through its members would appear to utilise the benefits of the mutuality principle so that the monies received from the notional members would not be classified as income for the purposes of the ITA Act.

The alternative to the 'notional temporary membership' category for non-members / unaccompanied guests would be for the ski club to account and remit tax separately on income derived from these sources. Clubs could then determine whether the external sources of income are exempt from income tax because of section 50-70 of the ITA Act.

This methodology may ensure easier compliance with taxation obligations, particularly for those ski clubs where a significant proportion of their income is derived from non-member sources. It may be more difficult for a club to establish that income derived from outside the mutuality principle is exempt if the income was remitted and declared in conjunction with that from members. As previously discussed, we believe that income received from bookings from non-members and allowing bookings outside the ski season can be classified as exempt as it provides the additional income needed to support the club.

Conclusion

Many ski clubs structured as incorporated associations may currently be engaging in conduct that breaches the trading prohibitions under the AI Act. While the amendments removing the prohibition should be in effect by 1 December 2011, until proclamation of the Amending Act occurs, clubs must be careful not to breach the AI Act or risk significant penalties. While the amendments will lift the restrictions on trading activities, incorporated associations must ensure that their activities are not outside the scope of the stated objectives of the club. Failure to comply can result in action by members, the association or the Registrar to restrict beyond power actions or enforce compliance with the ski club's rules.

We advise clubs the drafting of the objects, not-for-profit and dissolution clauses are critical when preparing a club's constituent documents to ensure eligibility for the income tax exemption. Further, engaging in activities that actually initiate participation in snow sports is recommended.

A ski club's objectives should include the encouragement of snow sports, and the dissolution clause must ensure that any surplus funds are not merely distributed to any not-for-profit organisation, but to one or more that also have the same or similar objectives as the ski club.

The ATO in February 2011 (NAT 73773 – 02.2011) released a *Guide for office bearers of non-profit clubs – income tax exemption and sporting clubs* in February 2011 (NAT 73773-02.2011). Included in the guide, which can be downloaded from www.ato.gov.au/nonprofit, is a self-assessment checklist which may assist ski clubs each financial year in determining whether all or some of its income is exempt.

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