

Mutuality and taxable income

This guide explains the principle of mutuality and helps non-profit clubs, societies and associations calculate their taxable income.



Use this guide if you are involved in the administration of a taxable non-profit organisation.



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ABOUT THIS GUIDE



This guide has been prepared for non-profit clubs, societies and associations that are taxable – that is, non-profit organisations that are not exempt from income tax.


It helps these organisations:

- work out if they need to lodge an annual income tax return
- calculate their taxable income, including how to treat mutual dealings with their members.

We developed this guide with representatives from the Clubs Consultative Forum.

 For information about the Clubs Consultative Forum, visit our website at www.ato.gov.au and select Community consultation – Non-profit – Clubs

Throughout this guide you will find important notes (look for the  and  symbols) that will help you with key information.

You will also find 'more information' boxes (look for the  symbol), which will show any further steps you may need to take or supplementary information you may need to refer to.

We often refer to NAT numbers. A NAT number is a unique national identifying number we give each of our publications to keep track of them. You can use this number to search for publications on our website and quote the number over the phone when you ask for a publication to be sent to you.

See the back of this guide for more information on how to access our publications and services.

Below is a list of the products that are referred to throughout this guide.

PUBLICATIONS

- *Am I eligible for the small business entity concessions?* (NAT 71874)
- *Consolidation reference manual*
- *Deductions for prepaid expenses* (NAT 4170)
- *Fringe benefits tax – a guide for employers* (NAT 1054)
- *Fringe benefits tax (FBT) and entertainment for non-profit organisations*
- *Fringe benefits tax for non-profit organisations*
- *Fundraising* (NAT 13095)
- *GiftPack* (NAT 3132)
- *GST for small business* (NAT 3014)
- *GST and gambling* (NAT 3018)
- *GST and vouchers – completing your activity statement* (NAT 10815)
- *GST tips for non-profit organisations*
- *Guide to capital gains tax* (NAT 4151)
- *Guide to capital gains tax concessions for small business* (NAT 8384)
- *Guide to company tax return for non-profit organisations* (NAT 73512)
- *Guide to depreciating assets* (NAT 1996)
- *Guide to small business and general business tax break*
- *Income and deductions for small business* (NAT 10710)
- *Income tax guide for non-profit organisations* (NAT 7967)
- *Record keeping in the pubs and clubs industry*
- *Tax basics for non-profit organisations* (NAT 7966)
- *Tips and gratuities* (NAT 72667)
- *Volunteers and tax* (NAT 4612)

RULINGS

- GSTR 2002/3 *Goods and services tax: prizes*
- TR 97/11 *Income tax: am I carrying on a business of primary production*
- TR 2004/5 *Income tax: taxation treatment of volume rebates paid to a retailer association*
- TR 2009/4 *Income tax: effective life of depreciating assets*

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This guide is for non-profit member-based organisations such as clubs, societies and associations that are taxable – that is, not exempt from income tax.

We explain which organisations are covered by this guide, and which ones are not.

You should use this guide if you are a financial officer, tax professional or other person involved in the administration of a taxable non-profit organisation.

For this guide to apply to your organisation, your organisation must be:

- non-profit, and
- taxable.

Note: This guide does not apply to all non-profit taxable organisations. For a list of organisations that are not covered, see 'Organisations not covered' on this page.

Examples of the types of organisations covered by this guide include:

- social clubs
- certain business and professional associations
- sporting clubs mainly engaged in providing hospitality services to their members.

➤ For more examples, refer to the table 'Industry codes commonly used by taxable non-profit member-based organisations' in our publication *Guide to company tax return for non-profit organisations* (NAT 73512).

NON-PROFIT

The basic premise of a non-profit organisation is that it is not operating for the profit or gain of its individual members, whether these gains would have been direct or indirect. This applies both while the organisation is operating and when it winds up.

Any profit made by the organisation goes back into the operation of the organisation to carry out its purposes and is not distributed to any of its members.

The Australian Taxation Office (ATO) accepts an organisation as non-profit where its constituent or governing documents prevent it from distributing profits or assets for the benefit of particular people – both while it is operating and when it winds up. These documents should contain **acceptable clauses** showing the organisation's **non-profit character**. The organisation's actions must be consistent with this requirement.

➤ For examples of clauses that indicate non-profit character, see chapter 2.

TAXABLE

⚠ Non-profit organisations can be either exempt or taxable.

Many non-profit organisations are taxable and may need to lodge income tax returns and pay income tax.

If your non-profit organisation is not exempt from income tax, it is taxable.

Only certain types of non-profit organisations are exempt from income tax. They come from these broad groups:

- charities
- community service organisations
- cultural organisations
- educational organisations
- employment organisations
- health organisations
- income tax exempt funds
- religious organisations
- resource development organisations
- scientific organisations
- sporting organisations.

➤ If you are unsure whether your non-profit organisation is taxable or exempt, refer to our publication *Income tax guide for non-profit organisations* (NAT 7967). It will help you work out your organisation's income tax status.

ORGANISATIONS NOT COVERED

This guide does not cover the following types of organisations:

- partnerships
- strata title bodies corporate
- friendly societies
- life assurance companies
- life insurance companies
- mutual insurance companies
- credit unions.

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- Tax rates **page 5**

For income tax purposes, taxable non-profit organisations are treated as either:

- non-profit companies, or
- other taxable companies.

This distinction is important because non-profit companies have special arrangements for lodging tax returns and special rates of income tax.

NON-PROFIT OR OTHER TAXABLE COMPANY

To work out if your organisation needs to lodge an income tax return and what rate of tax it pays, you first need to determine if your organisation is a non-profit company or other taxable company.

! A non-profit organisation does not need to be incorporated to be treated as a company for income tax purposes.

Non-profit companies

For your organisation to be a non-profit company it must meet the 'non-profit requirement'. This means:

- it must be a company that is not carried on for the purposes of profit or gain to its individual members, and
- its constituent documents must prohibit it from making any distribution, whether in money, property or otherwise, to its members.

Your organisation can be a non-profit company and still make a profit. However, any profits it makes must be used to carry out its purposes. The profits must not be distributed to members.

EXAMPLE

A society makes a \$40,000 profit for the year. It uses the profit to reduce its debts and provide for the activities it will carry on next year.

The prohibition on distributions applies while the organisation is operating and on its winding up. If it permits its members to transfer the assets to themselves on winding up, it is not a non-profit company.

A non-profit company can make payments to its members as bona fide remuneration for services they have provided to it, and as reasonable compensation for expenses incurred on behalf of the organisation.

The income tax law does not prescribe a form of words that a non-profit company must have in its constituent documents. The following example clauses would be acceptable, as long as other clauses were not contrary to them. The organisation's activities must be consistent with the clauses.

EXAMPLES

Non-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 another organisation with similar purposes and which has rules prohibiting the distribution of its assets and income to its members.'

Organisations carried on for the joint or common benefit of their members can qualify as non-profit companies. An example would be a professional association established to advance the professional interests of its members. However, the association must not be carried on for the profit or gain of its individual members.

Other taxable companies

Clubs, societies and associations that do not meet the 'non-profit requirement' (as discussed above) are treated as other taxable companies.

This means that other taxable companies will include clubs, societies and associations that are not carried on for the purposes of profit or gain to their individual members but whose constituent documents do **not** prohibit distributions to their members.

LODGMET RULES

Non-profit companies

Non-profit companies that are Australian residents have a taxable threshold. If the taxable income of a non-profit company in an income year is below the threshold (which is \$416 per year), it is not required to lodge a tax return for that year.


TABLE: Non-profit company lodgment rules

Taxable income	Is the company required to lodge a return?
0 – \$416	No. However, the ATO may notify a particular company that it is required to lodge a return.
\$417 and above	Yes.

 Taxable income is rounded down to the nearest dollar – that is, cents are ignored.

EXAMPLE

An organisation's taxable income is \$416.73. It reports its taxable income as \$416.


 We explain how to calculate taxable income in the next chapter.

Other taxable companies

Other taxable companies are taxed on every dollar of taxable income. They must lodge an income tax return each year.

Company tax return

Non-profit companies and other taxable companies use the company tax return to lodge a return.

 For information on how to complete the company tax return, refer to the *Guide to company tax return for non-profit organisations* (NAT 73512).

TAX RATES**TABLE: Non-profit company income tax rates**

Taxable income	Rate of tax
0 – \$416	Nil
\$417 – \$915	55% for every \$1 over \$416
\$916 and above	30% for every \$1 Note: If the taxable income is \$916 or more, the whole amount is taxable.

Non-profit companies

For non-profit companies, the income tax payable depends on the level of taxable income.

If the taxable income is \$416 or less for a year, no tax is payable.

EXAMPLE

A non-profit company has taxable income of \$416.84 in 2008–09.

The income tax is nil.

It is calculated as \$416 × nil.

If a non-profit company has a taxable income between \$417 and \$915 inclusive, the amount in excess of \$416 is taxed at 55%.

EXAMPLE

A non-profit company has taxable income of \$903.48 in 2008–09.

The income tax is \$267.85.

It is calculated as $(\$903 - \$416) \times 0.55$.

If the taxable income is more than \$915, the ordinary company tax rate is applied to all the taxable income at 30%.

EXAMPLE

A non-profit company has taxable income of \$2,182.92 in 2008–09.

The income tax is \$654.60.

It is calculated as $\$2,182 \times 0.30$.

Other taxable companies

Other taxable companies are taxable from the first dollar. That is, they are taxable on all levels of taxable income and there is no threshold. The rate of tax is 30%.

EXAMPLE

An 'other taxable company' has taxable income of \$1,109.43 in 2008–09.

The income tax is \$332.70.

It is calculated as $\$1,109 \times 0.30$.

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- Categories of revenue and expenses **page 9**
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The taxable income of a club, society or association is calculated in the same way as a company for tax purposes.

One particular aspect that affects many clubs, societies and associations is mutual dealings with members.

We explain how to identify whether a person is a member of an organisation.

As a result of the mutuality principle, revenue and expenditure of an organisation falls within one of three categories for income tax purposes.

We explain how the categories are used in calculating taxable income.

TAXABLE INCOME

Taxable income is calculated as the difference between an organisation's assessable income and deductions.

$$\text{Taxable income} = \text{assessable income} - \text{deductions}$$

➤ For examples of how to calculate taxable income, see chapter 8.

Assessable income

Assessable income is, broadly speaking, the income derived by your organisation. It can also include some capital gains made on the disposal of assets.

Many amounts received by a non-profit organisation are assessable income. Examples are bank interest and the proceeds from fundraising drives to the public.

Not all amounts of money or property your organisation receives will be assessable income. Receipts derived from mutual dealings with members of your organisation are not assessable income. This is due to the principle of mutuality, which we discuss later.

Deductions

Deductions are, broadly speaking, operating expenses that are incurred in earning assessable income. Examples of expenses incurred in deriving an organisation's assessable income are fees for earning bank interest and costs of fundraising drives to the public.

Your organisation may incur expenses in earning both assessable income and non-assessable income. The deduction your organisation will be able to claim will be limited to the extent the expenditure was incurred in deriving the assessable income. Therefore, your organisation may need to apportion its expenses.

For example, if only 30% of an organisation's bar sales are assessable, only 30% of expenses for running its bar will be deductible. Examples of other expenses that could be deductible but could require apportionment are printing, rent and insurance.

There are some deductions, however, that do not have to be incurred in deriving assessable income. They include tax-deductible gifts and superannuation contributions for employees.

Goods and services tax

The effect of goods and services tax (GST) on the calculation of taxable income differs depending on whether your organisation is registered for GST, or is required to be registered.

➤ For more information, see 'The effect of GST on taxable income' on page 41.

MUTUALITY PRINCIPLE

What is the mutuality principle?

The mutuality principle is a legal principle established by case law. It is based on the proposition that an organisation cannot derive income from itself.

The principle 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.

The principle does not extend to include income that is derived from sources outside that group.

Which organisations can access mutuality for income tax purposes?

The characteristics of organisations that can access mutuality typically include:

- The organisation is carried on for the benefit of its members collectively, not individually.
- The members of the organisation share a common purpose in which they all participate or are entitled to do so.
- The main purpose for which the organisation was established, and is operated, is the common purpose of the members.
- There is a common fund that gives effect to the common purpose and all the members contribute to it.
- All the contributions to the common fund are applied for the collective benefit of all the members, in line with the common purpose.
- Different classes of memberships may exist with varying subscription rates, rights and entitlements to facilities.
- The members have ownership and control of the common fund.
- The contributors to the common fund must be entitled to participate in any surplus of the common fund.*

Mutual dealings

As a result of the mutuality principle:

- receipts derived from mutual dealings with members are not assessable income (these are called mutual receipts)
- expenses incurred to get mutual receipts are not deductible.

⚠ Not all dealings involving members are mutual dealings.

The principle of mutuality does not apply to dealings between an organisation and member that go beyond a mutual arrangement and are in the nature of trade. In this situation, the fact the organisation is dealing with a member is not relevant.

Nature of trade

The definition of 'business' under tax law includes 'a trade'. The terms 'business' and 'trade' are commonly used to refer to activities that are commercial in nature and intended to produce a profit. These activities are usually for a taxable purpose.

However, the courts and tax law confirm that a mutual organisation may be carrying on a business (or trade) if various indicators are present. The indicators of business are outlined in TR 97/11 *Income tax: am I carrying on a business of primary production?* We also accept that the capacity to earn and distribute profits need not be present before an activity of a non-profit entity has the form of a business.

A mutual organisation's business can either be for a taxable purpose (producing assessable income) or non-taxable purpose (producing mutual receipts), or a combination of both.

If a mutual organisation is carrying on a business, it may, in certain circumstances, be eligible for concessions available to small business entities (for example, capital gains tax concessions and immediate deductions for prepaid expenses).

➤ To work out if your organisation is a small business entity, see page 22.

* If an organisation's constituent document prevents it from making any distribution to its members, and this is the only thing that prevents an amount of its income from being a mutual receipt, the organisation is not precluded from accessing mutuality for income tax purposes.

Dealings with members

When an organisation transacts with its members, it must ask itself the question ‘Is the activity:

- a trade or something in the nature of trade producing a profit (a taxable purpose), or
- a mutual arrangement which, at most, gives rise to a surplus of funds to the organisation (a non-taxable purpose)?’

In a mutual arrangement, there must be complete identity between contributors and participants as a class, not individually, in the surplus of common funds. The members collectively contribute and collectively benefit from the common fund.

Where an organisation transacts with members collectively to produce a surplus of common funds, the activity is for a non-taxable purpose and is a mutual arrangement. For example, a bar is provided for the benefit of all members so the sales from members contribute to a surplus of common funds.

Mutuality ceases to apply when a member individually ‘contributes’ – say by paying rent – to secure a right over the use of a collectively owned asset (where that right is not available to members as a class), and the member benefits from the use of that asset for their own purposes. This breaks the complete identity between contributors and participants as a class in the common fund.

Where the organisation transacts with a member in this way, the activity is in the nature of a trade and is for a taxable purpose. For example, leasing a club facility to a member for their individual benefit in earning their assessable income is in the nature of trade and so the lease income is assessable to the club.

EXAMPLE

A non-profit club owns two factory units. One is used for club activities and the other is rented to a club member. The member uses the unit to carry on a business.

The club’s activity involving the leasing of a factory unit to one club member is considered to be of a business nature rather than a mutual arrangement. Income from this activity is assessable to the club.

MEANING OF MEMBER

For the purposes of mutuality, we accept that a person is a member of an organisation where the person has:

- applied for membership (which may entail being nominated and paying the appropriate nomination fee)
- been accepted by the organisation (for example, by the board of directors), and
- paid the appropriate membership subscription.

Once a person has applied for membership and has been accepted by the organisation as a member, they are bound by the organisation’s constitution and any rules or by-laws of the organisation.

Members need not have voting rights, but those who do not must be eligible to the other rights and privileges of membership. This would include knowing that they are a member, receiving the appropriate membership identification (for example, a card or badge) and receiving the organisation’s newsletters and publications.

Various terms are used to describe members – for example, temporary, honorary, social and reciprocal members. As the meanings of these terms can differ between organisations, the use of a particular term does not determine whether a person is a member or non-member for tax purposes.

The general principle is that temporary, honorary or social members who have **not** been through the above membership process are visitors for tax purposes. This also applies to reciprocal members – that is, members of another organisation sharing reciprocal arrangements.

Non-members

A non-member is someone who is not a member of the organisation. Non-members include:

- temporary, honorary, social and reciprocal members who have not been through the above membership process and are treated as visitors
- members’ guests – those visitors who accompany a member and are signed in by the member
- other visitors.

A visitor to the organisation includes anyone who is **not**:

- a member
- a child
- an employee of the organisation*
- engaged to work or provide services to the organisation.*

* This only applies while the person is on the organisation’s premises in their capacity as an employee or contractor.

EXAMPLE

An employee is not counted as a visitor when they are at the organisation performing their duties.

However, if the employee visits the organisation on a day off (and is not a member), they are counted as a visitor on that day.

CATEGORIES OF REVENUE AND EXPENSES

As a result of the mutuality principle, revenue and expenses fall within one of three categories for tax purposes.

Category	Revenue	Expenses
1	Non-assessable <ul style="list-style-type: none"> ■ Revenue from mutual dealings with members (for example, membership subscriptions). ■ Revenue that the tax law classifies as not assessable (for example, donations received). 	Non-deductible <ul style="list-style-type: none"> ■ Expenses relating to members (for example, the cost of membership badges). ■ Expenses that the tax law specifies as non-deductible (for example, fines and penalties imposed by an Australian law).
2	Assessable <ul style="list-style-type: none"> ■ Revenue from trading activities relating to non-members (for example, fees from hiring function rooms to the public). ■ Revenue from sources outside the organisation (for example, bank interest received). ■ Revenue that the tax law specifies as assessable (for example, payments received to fulfil a lease obligation to repair). 	Deductible <ul style="list-style-type: none"> ■ Expenses relating to non-members (for example, the cost of running a function solely for non-members). ■ Expenses relating to fully assessable income (for example, fees for earning bank interest). ■ Expenses that the tax law allows without apportionment (for example, contributions to staff superannuation).
3	Apportionable <ul style="list-style-type: none"> ■ Revenue from trading activities relating to members and non-members (for example, bar sales). 	Apportionable <ul style="list-style-type: none"> ■ Expenses of trading activities relating to members and non-members (for example, bar expenses).

STEPS FOR CALCULATING TAXABLE INCOME

This flowchart shows how the three categories of revenue and expenses are used in calculating taxable income.

STEP 1: Classify revenue

Classify the organisation's revenue into one of the following categories:

- non-assessable
- **assessable**
- apportionable

We explain how to do this in chapter 4.



STEP 2: Classify expenses

Classify the organisation's expenses into one of the following categories:

- non-deductible
- **deductible**
- apportionable

We explain how to do this in chapter 5.



STEP 3: Separate the apportionable items

Separate the apportionable revenue and expenses into:

- non-assessable and **assessable**
- non-deductible and **deductible**

We explain how to do this in chapter 6.



STEP 4: Calculate the taxable income

Total the assessable income (from steps 1 and 3) and the deductible expenses (from steps 2 and 3). Once you have done this, you can calculate the taxable income.

Taxable income = assessable income – deductions

We provide worked examples of how to calculate taxable income in chapter 8.

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- Classification of common revenue **page 18**

To calculate taxable income, an organisation will need to classify its revenue as:

- non-assessable
- assessable, or
- apportionable.

NON-ASSESSABLE INCOME

The following receipts are not assessable income for tax purposes:

- mutual receipts
- receipts classified under income tax law as non-assessable income, including exempt income and non-assessable, non-exempt income.

Mutual receipts

Receipts derived from mutual dealings with members of your organisation are called mutual receipts.

! Mutual receipts are not exempt income.

There is a misconception held by some that mutual receipts are exempt income.

For non-profit organisations that are:

- non-profit companies – the income tax law classifies mutual receipts as non-assessable, non-exempt income.
- other taxable companies – case law has established that mutual receipts are not ‘income’. To be ‘exempt income’ under the income tax law, an amount must first be considered income. If an amount is not income in the first place, it cannot be exempt income.

The result of this is that mutual receipts are not subject to income tax because they are not assessable income – not because they are exempt income.

Mutual receipts include:

- member subscriptions and levies
- fees from members using the organisation’s facilities (for example, gyms, pools and squash courts)
- drinks and food sold by the organisation to members
- amounts members pay to attend dinners, parties, dances or social functions arranged by the organisation
- amounts members pay to attend a talk, workshop or presentation arranged by the organisation
- the sale of items, such as souvenirs, to members.

EXAMPLE

A non-profit club arranges for clothing to be made to its own design once or twice a year. The clothing is sold to the members. Not all members choose to purchase the clothing. Sales are put into the club’s general funds, which are used to pay operating costs.

The sale of the clothing to members is a mutual arrangement so the proceeds do not form part of the assessable income of the club. The fact that not all members purchase the clothing is not crucial to the mutuality principle.

In the event an organisation sells items to members at a profit, the revenue would also be classified as mutual receipts.

Revenue classified as non-assessable under tax law

Income tax law classifies the following revenue as non-assessable – any amount that is:

- **not** ordinary income (income other than from rendering personal services, from property and from carrying on trading activities)
- **not** an amount specified under income tax law as income.

EXAMPLE

A non-profit society receives donations from both members and non-members.

The donations are non-assessable income regardless of who makes them. Donations are given voluntarily and are not income from rendering personal services, income from property or income from the carrying on of trading activities. Donations are also not specified as income under income tax law.

Non-assessable income also includes an amount specified under income tax law as:

- non-assessable, non-exempt income (for example, mutual receipts of non-profit companies)
- exempt income (for example, the annual total of \$300 or less of non-cash benefits – property or services – received in payment for goods and services provided by the organisation).

EXAMPLE

A non-member hires a non-profit club's function room for \$300 and pays the club by giving it office equipment worth \$300. This was the only non-cash benefit the club received for the income year.

As the annual total of non-cash benefits the club received for the year was \$300, this revenue is exempt income.

ASSESSABLE INCOME

Many amounts received by your organisation will be assessable income. Assessable income is any amount that is:

- ordinary income (income from rendering personal services, income from property and income from carrying on trading activities)
- an amount specified under income tax law as income
- **not** an amount specified under income tax law as exempt income or non-assessable, non-exempt income.

Assessable income includes receipts from trading with non-members and income from sources outside the organisation.

Receipts that are assessable income include:

- bank interest
- dividends and other income from investments (for example, interest from term deposits and rent from an investment property)
- the annual total of more than \$300 of non-cash benefits (property or services) received in payment for goods and services provided by the organisation
- fees received for advertising in the organisation's magazine
- employee contributions that reduce the organisation's fringe benefits tax (FBT) liability
- sponsorships and certain grants
- proceeds from fundraising drives to the public (for example, the sale of lamingtons, cakes or chocolates)
- food and drinks sold to non-members visiting the organisation
- fees received for hiring out the organisation's hall, facilities or equipment to the public
- fees received for the organisation's catering services at functions for the public
- commissions received from vending machines
- amounts non-members pay to attend dinners, parties, dances or social functions arranged by the organisation
- amounts non-members pay to attend a talk, presentation or workshop arranged by the organisation

- non-member proceeds from a raffle
- proceeds from selling souvenirs to non-members
- gaming income derived by the organisation from non-members where the organisation owns and operates the gaming machines
- gaming income derived by the organisation under arrangements entered into with an external gaming or Keno operator.

➤ For more examples of assessable income, refer to *Income and deductions for small business* (NAT 10710).

⚠ The disposal of an asset may result in a capital gain or loss to an organisation (see chapter 7). If your organisation uses a depreciable asset for a taxable purpose, the disposal of the asset may also result in an amount to be treated as assessable income or a deduction (see chapter 5).

Non-mutual dealings with members

⚠ Not all dealings involving members are mutual dealings.

Although receipts may be received from a member, if they are from activities that go beyond a mutual arrangement and are in the nature of trade, the receipts are assessable income.

EXAMPLE

A non-profit club leases part of its premises to a member so the member can operate a gym business.

This activity is of a business nature rather than a mutual arrangement. As such, the lease payments from the member to the club will form part of the club's assessable income.

➤ For an explanation of the 'nature of trade', see page 7.

Arrangements with external parties

Non-profit organisations often enter into arrangements with external parties under which the external party conducts or provides particular operations on the organisation's premises. This may include the operation of gaming machines.

If an organisation enters into an arrangement with an external gaming operator under which gaming machines are installed on the organisation's premises, the gaming income is derived by the gaming operator from the players, according to the contractual arrangements and relevant state legislation.

The amounts paid or allowed to an organisation by the gaming operator under this arrangement are derived by the organisation from the external gaming operator and not from the members and non-members.

Therefore, such income is fully assessable to the organisation because it is derived from an external source and is not subject to the principle of mutuality.

Other arrangements your organisation may have with external parties include Keno, TAB type facilities, catering, entertainment activities and vending machines.

Under these arrangements, amounts paid or allowed to your organisation by the external operators, such as the licensees of the Keno game in respect of Keno, are not derived from your organisation's members and are, therefore, assessable.

We consider such amounts to be similar to the insurance commissions which have been held not to be mutual receipts by the courts. As such, organisations should **not** apply their non-member percentage to these or other similar types of income in calculating their assessable income.

EXAMPLES

Example 1

The Cordovan Club has a TAB outlet, Keno and food and drink vending machines on its premises. All are provided through external operators.

The amounts received from the external operators are not mutual receipts and are assessable income of the club. These amounts should not be reduced by the application of the non-member percentage in calculating the club's assessable income.

Example 2

Under an arrangement with the Chartreuse Club, an independent restaurateur operates a restaurant on the club's premises. Similarly, a gymnasium is also operated by an external party on the club's premises.

The income received by the club from these business operators is derived from an external source and is assessable.

Example 3

Gaming machines are installed on the premises of the Goldfields Country Club by a gaming operator. The club derives income from the machines under a contract entered into with that gaming operator. The club also engages an entertainment operator to provide entertainment to attract members and visitors (so that they will play the gaming machines) and receives a fee from the operator.

The income received by the club from these operations is assessable.

Gaming machines owned by non-profit organisations

Under the principle of mutuality, you apportion the revenue from gaming machines where the machines are:

- owned or leased by your organisation
- operated by your organisation, and
- played by members and non-members.

Coin-operated machines

Coin-operated machines include vending machines, payphones, amusement machines and pool tables. Non-profit organisations may own or rent these machines or provide them under an arrangement with an external party.

The revenue from the machines is apportioned if:

- the organisation owns or rents the machines
- the organisation is entitled to collect the monies as its income, and
- members and non-members use the machines.

If the machines are under an arrangement with an external party and the organisation receives a commission, then the commission is fully assessable income.

Employee contributions towards fringe benefits

If a non-profit organisation is an employer, an employee contribution generally refers to the amount of consideration paid to it or a provider by an employee in respect of a fringe benefit – for example, an association provides its employee with a car and the employee pays the association an amount towards the costs of petrol and oil. The contribution is reduced by the amount of any re-imbursment paid by the organisation to the employee in respect of that consideration.

If your organisation receives employee contributions, they are assessable income to it as the employer. As a general rule, the costs incurred by an organisation in providing fringe benefits are income tax deductible.

The principle of mutuality does not apply because the employee contribution is regarded as an external party transaction where the employee is assisting the organisation with an FBT liability.

➤ For more information on employee contributions, refer to *Fringe benefits tax for non-profit organisations*.

Tips from customers

If your non-profit organisation operates a trading activity such as a restaurant, bistro or bar, or holds a function, it may receive tips (or gratuities) from customers.

If the tips are voluntarily paid by customers and your organisation distributes all the tips to its employees or contractors, the tips are not assessable income to the organisation. However, if your organisation keeps all or some of the tips, the retained amounts are assessable income.

If the tips are non-voluntarily paid by customers (for example, for a pre-set amount, a surcharge or a service charge), the tips are assessable income to the organisation.

The principle of mutuality applies to the retained voluntary tips and non-voluntary tips where the trading activity or function is for members only (mutual receipts), or for member and non-member customers (apportionable revenue). Mutuality would not apply if the trading activity or function is for non-members only.

➤ For more information, refer to *Tips and gratuities* (NAT 72667).

Sponsorships

Under a sponsorship arrangement, when an organisation undertakes a fundraising activity it often receives support in the form of money. In return, it may provide such things as advertising, signage or naming rights or some other type of benefit of value.

This means that the sponsor receives something of value in return for the sponsorship, so the sponsorship payment is not a gift. The payment is fully assessable because of the commercial nature of the sponsorship arrangement.

Grants

Often organisations secure funding from government bodies and the private sector. The funding can be in the form of grants.

Government industry payments – in the form of grants, bounties, subsidies and rebates – are from federal, state, territory or local governments or government agencies to help recipients to continue, commence or cease business.

Regardless of where they are from, grants that help an organisation continue its income-producing activities are assessable income at the time they are derived (that is, 'taken to be received' for income tax purposes). A grant may be derived in the same income year as it is paid or it may be derived in a later income year.

Conditional grants are grants that must be repaid unless the recipient meets agreed conditions within a specified period. Once the conditions of the grant are satisfied, the grant becomes unconditional and is assessable income at that time, not when the grant was paid. This means that the grant is derived as assessable income in the year it becomes unconditional.

EXAMPLE

The Terracotta Club receives an unconditional grant of \$5,000 to fund certain operating costs to help with its income-producing activities in the 2008–09 year. The \$5,000 grant is derived as assessable income in the income year it is received – that is, the 2008–09 year because the grant is unconditional.

If the Terracotta Club receives the \$5,000 as a conditional grant in the 2008–09 year, the grant is not derived until the conditions are met. In this case, the required conditions are met in the 2009–10 income year, so the \$5,000 becomes assessable in that year.

If in the 2008–09 year the club instead receives a \$10,000 conditional grant that is paid in two instalments of \$5,000, each instalment is derived in the income year the club meets the conditions for that instalment. In this case:

- the conditions for the first instalment are met in the 2008–09 income year and so the instalment is assessable in that year
- the conditions for the second instalment are met in the 2009–10 income year and so the instalment is assessable in that year.

If an organisation fails to meet the terms of a conditional grant and is required to repay the whole or part of the grant, the amount that is repaid is not assessable income in any year. Because the amount that was repaid is not assessable income, it cannot be claimed as a deduction. If, however, the organisation has used grant monies, prior to it being repaid, to incur expenses in earning its assessable income, the organisation can claim those expenses as a deduction.

EXAMPLE

If the Terracotta Club fails to meet the terms of the conditional grant of \$5,000 and is required to repay it, the \$5,000 is not derived as assessable income in any year.

If the club fails to meet the terms for the last \$5,000 instalment of the \$10,000 conditional grant, that instalment is not derived as assessable income in any year.

Rebates

Rebates can be either government industry payments or from private organisations such as wholesalers.

A rebate from a federal, state, territory or local government or government agency is a payment to offset a liability – that is, a payment to assist with operating costs or liabilities. A tax rebate is provided under a federal, state or territory law to organisations that are entitled to it. Where the rebate is received to offset a tax liability that arises because of business operations, the rebate is ordinary income and is assessable in the income year it is received.

The principle of mutuality does not apply to these rebates. They do not require apportionment because the rebates are the result of an external party arrangement between the government body and the organisation.

EXAMPLE

Under the Community Development and Support Expenditure (CDSE) Scheme in New South Wales (NSW), eligible clubs may receive a tax rebate on their annual gaming machine tax (that is, a rebate of up to 1.5% of their annual gaming machine profits over \$1 million) if they have expended an equivalent amount on eligible community programs and services.

The tax rebate is provided under the state *Gaming Machine Tax Act 2001* and clubs are entitled to it if they have annual gaming machine profits over \$1 million, they expend on eligible community programs and services, and they provide evidence to the Casino, Liquor and Gaming Control Authority of those payments.

The rebate is a payment to offset the annual gaming machine tax liability that these clubs are required to pay under state law. Therefore, the rebate is assessable income in the income tax year it is received.

Rebates may also be offered by private organisations. For example, retailers may be entitled to a volume rebate when they make qualifying purchases from a wholesaler. A rebate from a private organisation is considered an arrangement with an external party and so is fully assessable income to the entity that is entitled to the rebate.

In the case where an organisation acts as an agent for its members, receives a rebate on behalf of its members and then passes on the rebate to its members, the rebate is not assessable income to the organisation.

EXAMPLE

A non-profit retailer association receives volume rebates from a wholesaler on behalf of its retailer members. The members are entitled to the rebates because of qualifying purchases they made from the wholesaler.

The association spends part of the rebates on administrative overheads and on activities benefiting members individually or collectively. The remaining balance of the rebates is then paid to the members according to their share of purchases from the wholesaler.

The rebates are not assessable income to the association. This is because the association is not entitled to the rebates and is only acting as an agent for its members. Also, the expenses related to the rebates are not deductible to the organisation. It is the members who are entitled to the rebates that need to include the rebates and expenses as assessable income and deductions.

➤ For more information on retailer associations and volume rebates, refer to TR 2004/5 *Income tax: taxation treatment of volume rebates paid to a retailer association*.

'GST rebate' on gaming machines

In NSW, the Office of State Revenue (OSR) pays a 'GST rebate' to clubs with gaming machines at the end of each quarter to compensate for the impact of the goods and services tax (GST). The payment is currently under a memorandum of understanding between the NSW Government and Clubs NSW.

For income tax purposes, the 'GST rebate' payments received in a club's income tax year are assessable income. The payments are not a reduction in a club's GST liability on its gaming machine revenue because the GST law does not include a rebate on GST. The 'GST rebate' paid by the OSR is a government industry payment to help compensate clubs for their GST liability.

The principle of mutuality does not apply to the 'GST rebate' payments. They do not require apportionment because the payments from the OSR are the result of an external party arrangement (that is, an agreement between the OSR and Clubs NSW).

Hotels, motels, gyms, squash courts, swimming pools

Taxable non-profit organisations may have hotels, motels, gyms, squash courts, swimming pools or other such facilities.

Where an organisation leases out a facility it owns to an external operator, the lease revenue is fully assessable regardless of who uses the facility.

EXAMPLE

A non-profit club owns a motel and leases it out to a motel operator. The lease revenue received by the club is assessable, even though guests at the motel may include club members.

Similarly, where an organisation owns a facility and operates it purely as a commercial investment to generate income and the facility does not form part of the organisation's facilities for its members, the revenue from the facility is fully assessable income.

EXAMPLE

A non-profit sporting club owns and operates a hotel purely as an investment to earn income. The hotel is not used in pursuing the club's purposes for which it was established. The income the club receives from the hotel is assessable, even though guests at the hotel may include club members.

Where an organisation sets up a facility for the benefit of its members but allows non-members to use it, the revenue needs to be apportioned.

In the case where an organisation operates a facility for its members only, the revenue, if any, is classified as mutual receipts.

Revenue specified as assessable under tax law

Revenue specified under income tax law as assessable income includes:

- interest on any overpayment of federal tax
- amounts received from a lessee or former lessee for failing to comply with a lease obligation to make repairs to the premises you leased to them to run a business.

EXAMPLE

The Viridian Club leases part of its premises for two years to an individual to operate a gym. The lease contract includes an obligation for the gym operator to repair and maintain the leased premises.

After one year, the leased premises needed some repair work. When the lease ended, the club charged the gym operator an amount agreed under the contract for failing to comply with his obligation to carry out the repairs.

The agreed amount the club received from the gym operator is assessable income.

APPORTIONABLE REVENUE

Apportionable revenue is revenue that comprises both assessable and non-assessable income.

This revenue needs to be separated using a practical and suitable method.

➤ For information on the methods of apportionment, see chapter 6.

Revenue that may need to be apportioned includes:

- drinks sold at the bar to members and non-members
- meals sold to members and non-members at an organisation's restaurant/bistro
- fees from members and non-members using the organisation's facilities, such as gyms, pools and squash courts
- amounts members and non-members pay to attend dinners, parties, dances or social functions arranged by the organisation
- amounts members and non-members pay to attend a talk, workshop or presentation arranged by the organisation
- member and non-member proceeds from a raffle
- gaming income derived by an organisation from members and non-members where the organisation owns and operates the gaming machines.

CLASSIFICATION OF COMMON REVENUE

! The table below provides general guidance only.

The classification of your organisation's revenue will depend on its particular facts and circumstances.

EXAMPLE

Bar sales are shown as apportionable on the basis the bar is available to both members and non-members.

If, however, the bar is only available to:

- non-members, the sales are fully assessable
- members, the sales are non-assessable.

Description	Non-assessable	Assessable	Apportionable
Accommodation takings (motel, hotel)			✓
Admission fees			✓
Advertising income		✓	
Amusement machine commissions		✓	
Amusement machine income (owned)			✓
Bar sales			✓
Competition fees	✓		
Donations	✓		
Employee contributions that reduce FBT liability		✓	
Entertainment income			✓
Gaming machine commissions		✓	
Gaming machine income (owned or leased)			✓
Gaming machine tax rebate (CDSE Scheme) – NSW		✓	
Government industry payments		✓	
Grants		✓	
GST rebate payment – NSW		✓	
Gym fees			✓
Hire of equipment/videos			✓
Hire of facilities for functions			✓
Insurance commissions		✓	
Investment income – dividends		✓	
Investment income – interest		✓	
Investment income – other description		✓	
Investment income – rental income		✓	
Investment income – trust distributions		✓	

Description	Non-assessable	Assessable	Apportionable
Keno commissions		✓	
Member access to facilities	✓		
Membership levies	✓		
Membership subscriptions	✓		
Non-cash benefits received (annual total of \$300 or less)	✓		
Non-cash benefits received (annual total of more than \$300)		✓	
Payphone commissions or agreed amount		✓	
Payphone income (owned or rented)			✓
Pool tables (owned)			✓
Profit on sale of asset (as capital gain)		✓	
Raffles and bingo			✓
Rebates from private organisations		✓	
Rental income from members		✓	
Restaurant/bistro sales			✓
Revenue from visitors and members' guests		✓	
Sale of merchandise			✓
Scratch lotteries		✓	
Sponsorship income		✓	
TAB commissions		✓	
Tips (non-voluntary) from customers			✓
Tips (voluntary) from customers (if all paid to employees)	✓		
Vending machine commissions		✓	

➤ For worked examples of classifying revenue, see chapter 8.

➤ RECORD KEEPING

For information on what records to keep for revenue items, see our web-only fact sheet *Record keeping in the pubs and clubs industry* and our publication *Tax basics for non-profit organisations* (NAT 7966).

05

CLASSIFYING EXPENSES

- Non-deductible expenses **page 20**
- Deductible expenses **page 21**
- Apportionable expenses **page 26**
- Classification of common expenses **page 28**

To calculate taxable income, an organisation will need to classify its expenses as:

- non-deductible
- deductible, or
- apportionable.

NON-DEDUCTIBLE EXPENSES

The following expenses are not deductible for tax purposes:

- expenses used to get mutual receipts
- expenses classified under income tax law as non-deductible.

Expenses used to get mutual receipts

Generally, where an organisation has non-assessable income, the expenses it incurs to get that revenue will not be deductible.

Mutual receipts are not assessable income. Therefore, costs incurred to get mutual receipts are not deductible. Also, under the mutuality principle, where other expenses are incurred when dealing with members, these costs cannot be claimed as deductions.

Expenses used to get mutual receipts include the costs of:

- collecting membership subscriptions
- increasing membership
- member loyalty schemes
- running member-only facilities such as gyms, pools and squash courts
- drinks sold at the bar to members
- food and beverages sold to members
- running member-only functions (for example, dinners, parties, dances, presentations and workshops).

Other expenses incurred when dealing with members include the costs of:

- running an annual general meeting
- producing a member-only magazine
- scholarships and awards for members
- members' discounts
- members' badges
- members' birthdays
- wreaths, flowers and hospital visits to members.

⚠ Not all dealings involving members are mutual dealings.

Where an organisation and a member enter into a transaction that is in the nature of trade, the expenses incurred by the organisation in relation to the transaction may be deductible.

EXAMPLE

A non-profit club leases part of its premises to a member so the member can operate a gym business.

Expenses the club incurs in relation to the lease income may be deductible.

➔ For an explanation of the 'nature of trade', see page 7.

Expenses classified as non-deductible under tax law

Income tax law classifies what expenses are non-deductible. These expenses are losses or outgoings that are:

- not incurred in earning assessable income
- incurred in earning non-assessable income
- capital or of a capital nature
- of a private or domestic nature
- incurred in earning exempt income or non-assessable, non-exempt income
- specified under income tax law as non-deductible.

EXAMPLE

A non-profit association has paid various awards and scholarships for the benefit of its members. The funds to pay these amounts have been derived from interest earned from the investment of bequests from members. The interest earned is part of the association's assessable income.

The scholarship and award expenses are not deductible, as they are incurred when dealing with members. This does not change even when the expenses are paid out of the association's assessable income. The costs of the scholarships and awards are not necessary in directly earning the interest income from the investment of moneys bequeathed by members.

Expenses specified under income tax law as non-deductible include:

- fines and penalties imposed under an Australian or foreign law, or ordered by the courts
- borrowing expenses related to a loan that was taken out to pay a federal tax liability
- fees for advice on the operation of a federal tax law (except where the advice is given by a registered tax agent or legal practitioner)
- provisions for employees' long service leave, annual leave, sick leave or other leave (except where the organisation actually paid these amounts to an employee).

DEDUCTIBLE EXPENSES

Generally, deductions are operating expenses that are incurred in earning an organisation's assessable income. Expenses that are deductible include:

- costs of running a function solely for non-members
- costs of running a purely commercial trading activity, including employees' salary and wages
- expenses for advertising trading activities to non-members
- fees for earning bank interest, dividends or investment income
- costs of fundraising drives to the public (for example, buying promotional buttons sold to the public)
- expenses related to gaming income derived by an organisation from non-members where the organisation owns or leases, and operates, the gaming machines
- expenses related to gaming income derived by an organisation under arrangements entered into with an external gaming or Keno operator.

➤ For more examples of deductions, refer to *Income and deductions for small business* (NAT 10710).

Tips paid to employees

If your organisation receives non-voluntary tips from customers (for example, for a pre-set amount, a surcharge or a service charge) and pays these tips to its employees or contractors, it can usually claim a deduction for the amount it paid.

The mutuality principle applies to the amount paid to employees or contractors where the customers are at a trading activity or function for members only (non-deductible expenses), or for both members and non-members (apportionable expenses). If the trading activity or function is for non-members only, the amount paid is fully deductible to the organisation.

However, if your organisation receives voluntary tips and pays all the tips to its employees or contractors, it cannot claim a deduction for the amount it paid because the tips are not assessable income to the organisation.

➤ For more information, refer to *Tips and gratuities* (NAT 72667).

Bad debts

A non-profit organisation can deduct a debt, or part of a debt, that it writes off as bad in an income year if the amount was included in the assessable income of the organisation for that year or for an earlier year.

Where the bad debt, or part of the debt, is related to mutual receipts, it is not deductible.

Sponsorship costs

If your organisation receives a payment for providing such things as advertising space, signage or naming rights, the costs incurred in earning this income may be deductible in full.

Your organisation's costs to sponsor others or promote itself may need to be apportioned to the extent that the sponsorship or promotion is incurred in earning its assessable income.

Advertising to attract membership is not deductible. Sponsorship of a member's interests will generally not be deductible.

Gaming expenses

If your organisation enters into arrangements with external parties under which the external party conducts or provides particular operations on your organisation's premises – including the operation of gaming machines, Keno and TAB facilities – the income from the external operators is fully assessable. The expenses your organisation incurs in earning this income are fully deductible, including gaming tax.

However, under the principle of mutuality, apportionment of gaming expenses will be necessary if gaming machines are:

- owned or leased by the organisation
- operated by the organisation, and
- played by members and non-members.

For example, state tax (including 'tax shortfalls') on a club's gaming machine revenue is apportioned so that only that part of the tax (or shortfall) that relates to the non-member revenue is deductible.

Some state and territory gaming laws require organisations with gaming machines to make or record contributions to community purposes, such as:

- paying a community or gambling levy
- preparing community contribution statements
- making community contributions up to a required minimum.

Related expenditure is apportioned where the principle of mutuality applies. An exception is where the expenditure on community contributions is required to claim a rebate of gaming machine tax. As the rebate is fully assessable to the organisation, the expenditure is not subject to mutuality.

Regardless of whether mutuality applies, a deduction for expenditure on community contributions **cannot** include:

- notional amounts claimed for providing rooms or volunteers to other community groups – only actual costs may be deductible
- claims for capital expenditure
- amounts already claimed as a tax deduction.

A contribution to a deductible gift recipient (DGR) made to meet an organisation's minimum community contribution is not considered a tax-deductible gift.

EXAMPLES

Example 1

An eligible club participates in the Community Development and Support Expenditure (CDSE) Scheme in NSW. The scheme provides a tax rebate on the club's annual gaming machine profits. The rebate is fully assessable under income tax law. To receive the maximum rebate available, the club must expend eligible CDSE-related expenditure of at least \$210,000.

The club's actual CDSE-related expenditure for the year was \$220,000 and comprised:

- \$219,000 eligible expenditure on community projects and services (which included \$10,000 to DGRs)
- \$1,000 CDSE committee expenses.

No capital or in-kind (notional) expenditure was made.

Under state law, the club's actual CDSE-related expenditure of \$220,000 is \$10,000 above the required expenditure to claim the maximum rebate.

For income tax purposes, the club's tax deduction for its CDSE-related expenditure is:

$$\$219,000 + \$1,000 = \$220,000.$$

The club's required expenditure of \$210,000 is fully deductible under income tax law as it is incurred in earning the rebate as assessable income. As its \$10,000 payments to DGRs are extra to the required expenditure, the club may claim the payments to the DGRs as income tax deductible gifts.

Example 2

A non-profit club in Queensland is required by the state's gaming law to prepare and lodge an annual community benefit statement. The costs of preparing the statement are deductible to the extent of the non-member revenue from its gaming machines.

Where the club fails to lodge a statement and is subject to a penalty under the gaming law, the penalty is not a deduction under the income tax law.

As there is no minimum requirement for community benefit payments under a state gaming law, the club's payments to DGRs would be tax-deductible gifts.

Small business entity

If your organisation is a small business entity, it may be eligible for various concessions, including:

- immediate deduction for certain prepaid business expenses
- simplified depreciation rules
- small business tax break (2008–09 to 2010–11 income years inclusive).

Your organisation is a small business entity if it is a company that:

- is carrying a business for all or part of the year, and
- has an aggregated turnover of less than \$2 million – that is, your organisation's annual turnover plus the annual turnovers of any businesses it is connected or affiliated with.

➤ To work out if your organisation is carrying on a business, see 'Nature of trade' on page 7.

Turnover includes all ordinary income that your organisation earns in the ordinary course of business for an income year.

If your organisation is a non-profit company, its ordinary income includes its income from members.

TABLE: Turnover of non-profit companies

Include these amounts	Do not include these amounts
<ul style="list-style-type: none"> ■ revenue from sales to members and non-members ■ fees for services provided to members and non-members ■ interest from business bank accounts 	<ul style="list-style-type: none"> ■ GST the company has collected on a transaction ■ amounts borrowed for the business ■ proceeds from the sale of business capital assets

If your organisation is an 'other taxable' company, do not include mutual receipts in the calculation of aggregated turnover as they are not income.

- For more information, see:
- 'Mutual receipts' on page 11
 - *Am I eligible for the small business entity concessions?* (NAT 71874).

Prepaid expenses

Prepaid expenses are expenditure that is incurred for things done (in whole or in part) in a later income year. Where prepaid expenses are incurred in earning mutual receipts and assessable income, the expenses need to be apportioned under the principle of mutuality.

Generally, a prepaid expense is deductible over the eligible service period, or 10 years if that is less, rather than being immediately deductible.

The eligible service period:

- starts on the day the thing under an agreement begins to be done or on the day the expenditure is incurred, whichever is the later
- finishes at the end of the last day the thing under the agreement ceases to be done or 10 years, whichever is the earlier.

However, a prepaid expense may be immediately deductible if:

- it is excluded expenditure, or
- the 12-month rule applies.

Excluded expenditure includes:

- amounts of less than \$1,000
- amounts required to be incurred by a court order or federal, state or territory law
- payments of salary or wages (under a contract of service)
- amounts that are capital, private or domestic in nature.

EXAMPLE

The Carnelian Club is required under the Corporations Act to have its financial reports audited each financial year. It is not a 'small business entity'.

On 1 June 2009, the club contracts with an accounting firm to provide audit services for the following 12 months. Under the terms of the contract, the club is required to prepay the full audit fee of \$10,000.

Although the club is legally required to audit its accounts, there are no statutory fees required to be charged nor are the fees paid to a government body. The prepaid audit fees are not 'excluded expenditure' and the club is not entitled to an immediate deduction for the \$10,000 in the 2008–09 income year. The club must apportion the deduction over the period in which the services are provided. It will also need to apportion the prepaid audit fees if it is earning both mutual receipts and assessable income.

If your organisation is a small business entity, it may be entitled to an immediate deduction under the **12-month rule** if the prepaid expenses are incurred for an eligible service period not exceeding 12 months and the eligible service period ends in the income year following the year the expenses were incurred. If the eligible service period is more than 12 months, or ends after the next income year, you must apportion the deduction for the expenses over the eligible service period or 10 years, whichever is less.

- For more information, see:
- 'Small business entity' on page 22
 - *Deductions for prepaid expenses* (NAT 4170).

Depreciating assets/decline in value

Your organisation may be able to claim a deduction for the decline in value of its depreciating assets. A depreciating asset is an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used.

Examples of these assets include computers, cars, furniture and equipment.

To work out the decline in value of a depreciating asset, use either the prime cost or diminishing value method based on the effective life of the asset.

Generally, an amount for the decline in value of a depreciating asset is deducted to the extent the asset is used for a taxable purpose. A taxable purpose includes the purpose of producing assessable income.

A membership-based organisation can have a depreciating asset which, at some time when it was held, had been used or installed ready for use for a purpose other than a taxable purpose.

Under the principle of mutuality, receipts from mutual dealings with members are not assessable income. As a result, the use of depreciating assets in activities from which mutual receipts arise is not use for a taxable purpose.

Therefore, if a depreciating asset is used in part for producing assessable income, or used for part of the income year, your organisation cannot claim a deduction for the full amount.

EXAMPLE

A non-profit club owns poker machines that are played by members and non-members. The club works out the decline in value of each poker machine for the income year by using the method it chose based on the seven years effective life of each machine. The club then apportions the decline in value amount by the machines' non-member usage to work out the deduction for the year.

- For information on the effective lives of various depreciating assets, refer to:
- TR 2009/4 *Income tax: effective life of depreciating assets*
 - the *Decline in value calculator* on our website.

If your organisation is a small business entity, you may choose to calculate deductions for its depreciating assets using the simplified depreciation rules.

- For more information, see 'Small business entity' on page 22.

Your organisation may need to calculate a balancing adjustment amount for an asset to include in its assessable income or to claim as a deduction when:

- it stops holding it – for example, if the asset is sold, lost or destroyed
- it stops using it and expects never to use it again
- it stops having it installed ready for use and it expects never to install it ready for use
- it has not used it and decides never to use it
- a change occurs in the holding or interests in an asset which was or is to become a partnership asset.

You work out the balancing adjustment amount by comparing the asset's termination value (such as its sale proceeds) and its adjustable value at the time of the balancing adjustment event.

If the termination value is greater than the adjustable value, you include the excess in your organisation's assessable income. If the termination value is less than the adjustable value, you can deduct the difference.

EXAMPLE

The Ambrose Society purchased a cabinet that it held for two years and used wholly for a taxable non-member purpose. It then sold the cabinet for \$1,300. Its adjustable value at the time was \$1,200.

As the termination value of \$1,300 is greater than the adjustable value of the cabinet at the time of its sale, the difference of \$100 is included in assessable income.

If it sold the cabinet for \$1,000, the termination value would be less than the adjustable value of the cabinet at the time of its sale (\$1,200). The difference of \$200 would be a deductible balancing adjustment amount.

- For more information, refer to *Guide to depreciating assets* (NAT 1996).

Small business and general business tax break

The small business and general business tax break is an additional deduction for business investment in new, tangible depreciating assets and new expenditure on existing assets. That is, the deduction for the tax break is in addition to deductions for the decline in value you are entitled to claim for an asset. Certain expenditure is not eligible for the tax break – for example expenditure incurred in repairing an existing asset.

To be eligible for the tax break:

- new investment in an eligible asset must be made between 13 December 2008 and 31 December 2009
- the amount of the investment in an eligible asset needs to meet the new investment threshold (\$1,000 for small business entities or \$10,000 for all other business)
- when an eligible asset starts to be used, or is installed ready for use, the asset must be used principally in Australia for the principal purpose of carrying on a business
- you must be eligible to claim a deduction for the decline in value of an eligible asset. Therefore, if an asset is to be used solely for a non-taxable (member) purpose, you cannot claim a deduction for the tax break.

If your organisation is a small business entity, the tax break is worked out using a rate of 50%. If it is not a small business entity, the tax break is worked out using a rate of either 30% or 10%, depending on when you committed to investing in the asset and used it, or installed it ready for use.

Provided all of the eligibility criteria are satisfied for the income year, the tax break can be claimed as a deduction in the income tax return for the income year in which the asset is first used or installed ready for use.

Where an asset is to be used solely for non-assessable (member) purposes or where it is not reasonable to conclude that the asset will be used principally in Australia for the principal purpose of carrying on a business, a deduction for the tax break cannot be claimed. For more information about whether your organisation is carrying on a business, see 'Nature of trade' on page 7.

If an asset is eligible for the tax break, the deduction for the tax break is not apportioned for any member usage of the asset – the full tax break can be claimed as a deduction.

- For more information, see:
- 'Small business entity' on page 22
 - *Guide to small business and general business tax break.*

Investment expenses

Generally, costs incurred in earning investment income – such as rental income, interest, dividends and trust distributions – are deductible. Expenses may be for protecting and maintaining investments and can include rent collection fees, interest charged on money borrowed for investment, bookkeeping and secretarial expenses, audit fees, management fees and office expenses.

Where costs incurred relate to both assessable (investment income) and non-assessable income (mutual receipts), those expenses need to be apportioned.

EXAMPLE

The Gamboge Society mainly derives mutual receipts. The only non-member income it earns is investment income in the form of rent and interest. The society incurs various expenses including telephone, electricity, accounting and audit fees, management fees, insurance, rent collection fees and office expenses.

Only the rent collection fees are specifically related to the rental income and so are fully deductible. The other expenses need to be apportioned as they cannot be identified as relating to either the mutual receipts or the investment income.

Deductions specified under income tax law

Under the income tax law, there are some deductions that do not have to be incurred in deriving assessable income and the mutuality principle does not apply to them. They are:

- tax-deductible gifts
- the ATO fee to value property over \$5,000 for gift deductibility purposes
- the first \$42 of subscription fees to professional associations
- expenses for managing the organisation's tax affairs (for example, the costs of using a tax agent to prepare the organisation's tax return or business activity statement)
- the general interest charge or shortfall interest charge related to federal tax
- superannuation contributions for employees
- rates and land taxes on a non-profit organisation's premises wholly used to produce mutual receipts and/or assessable income.

Some deductions have limits on how much your organisation can deduct. These limits are discussed in the following sections.

Tax-deductible gifts

For your organisation to claim a tax deduction for a donation it makes, the payment must:

- be made to a deductible gift recipient (DGR)
- be truly a gift
- be a gift of money or a certain type of property, and
- comply with any relevant gift conditions.

Payments to DGRs that are not gifts, cannot be claimed as a gift deduction. Examples include:

- a payment for services supplied by the DGR
- a payment to a DGR made to meet an organisation's minimum required community contribution under a state or territory gaming law.

A deduction for a gift cannot add to or create a tax loss. However, your organisation can elect to spread out deductions for certain gifts over a period of up to five years.

➤ For more information on tax-deductible gifts, refer to *GiftPack* (NAT 3132).

Professional association subscriptions

Under income tax law, if your non-profit organisation pays to be a member of a professional association it can deduct the first \$42 of the subscription fee each year. This is regardless of whether your organisation incurs the expense in earning its assessable income.

Alternatively, under general principles, your organisation can claim a deduction if the subscription fee is incurred in earning its assessable income. However, the mutuality principle would apply. If the application of mutuality reduces the deductible amount of the subscription fee below \$42, you can choose to claim the income tax law deduction of the first \$42.

EXAMPLE

The Amaranth Club pays a \$350 annual subscription to a licensed clubs association. In turn, the club receives information from the association on how to promote itself better. This helps the club earn its member and non-member revenue.

The club can choose to claim the first \$42 of the subscription fee or to claim the non-member portion of the subscription fee.

If the club's non-member percentage is 30%, the club may choose to claim the non-member portion of the fee as a deduction - that is, \$105 ($\$350 \times 30\%$).

If, however, the club's non-member percentage is 10%, the non-member portion of the fee is \$35 ($\$350 \times 10\%$). In this situation the club may choose instead to deduct the first \$42 of the subscription fee.

Rates and land taxes

Your organisation can claim a deduction for the annual rates (that includes council, water, sewerage and drainage rates) and any land tax imposed by a state or territory law on its premises if the premises is wholly used for producing mutual receipts or assessable income or both.

Your organisation cannot claim a deduction if the premises, or part of the premises, it owns is not used for producing any revenue.

If your organisation receives a recoupment of the rates or land tax on premises used to produce its mutual receipts or assessable income, the recoupment is assessable income to the organisation.

APPORTIONABLE EXPENSES

Expenses related to earning both assessable income and non-assessable income need to be apportioned by using a practical and suitable method.

➤ For information on methods of apportionment, see chapter 6.

Expenses that may require apportionment include:

- printing
- postage
- stationery
- telephone
- electricity
- bank charges
- rent
- insurance
- audit fees and general accounting fees
- subscription fees to professional associations
- bad debts that relate to member and non-member revenue
- the decline in value on depreciating assets that are used to earn revenue from members and non-members
- directors' fees
- honoraria paid to volunteers who help the organisation with activities that relate to members and non-members
- employees' salary and wages where trading activities are for members and non-members
- costs of drinks sold at the bar to members and non-members
- costs of meals and beverages sold to members and non-members
- running costs of facilities used by members and non-members
- costs of dinners, parties, dances or social functions arranged by the organisation where members and non-members pay to attend
- expenses relating to a talk, workshop or presentation arranged by the organisation where members and non-members pay to attend
- costs of a raffle sold to members and non-members
- expenses related to gaming income derived by an organisation from members and non-members where it owns or leases, and operates the gaming machines.

Accounting and audit fees

Accounting fees may include the following:

- costs of managing tax affairs
- audit of account fees
- general accounting fees (for example, costs of keeping the accounts up-to-date).

Where the fees are for preparing and lodging income tax returns and activity statements, these costs are specified under income tax law as fully deductible.

However, fees for auditing accounts and general accounting are subject to the principle of mutuality and need to be apportioned where the accounts cover both mutual and non-mutual transactions.

Audit of accounts fees

Non-profit organisations may be required by their governing documents to audit their accounts. Also, state, territory and federal laws may require companies to undergo statutory audits.

Although constitutional and legislative requirements impose an obligation to have an audit performed for a particular year, audit fees are deductible:

- in the income year in which they are incurred, and
- to the extent they relate to the organisation's assessable income.

An organisation incurs audit fees when it is definitely committed to the liability, even if the fees are unpaid at the time. The commitment to the liability depends on the audit contract between the organisation and the auditor.

The following contractual arrangements indicate when the audit fees are incurred:

- full payment due on completion of the audit – fees are incurred when the audit is completed
- part payment due on early termination of the audit – fees are incurred for work performed when the termination occurs
- progressive payments due as particular work is performed in specified periods (for example, three months) – fees are incurred when bills are presented for work performed in these periods
- payment due for work done in an agreed period or on completion of a milestone in the audit – fees are incurred after the agreed period or at the time the auditor tells the organisation the milestone has been completed
- full payment due once the auditor expresses an opinion on the organisation's financial statements – fees are incurred when the auditor expresses the opinion
- full payment due on entering the audit contract but instalment payments accepted by the auditor – fees are incurred when the contract is entered into
- instalment payments due during the audit – fees are incurred when the instalments are due
- full payment due on commencement of the audit – see 'Prepaid expenses' (on page 23) for an explanation of when fees are deductible.

CLASSIFICATION OF COMMON EXPENSES

! The table below provides general guidance only.

The classification of your organisation's expenses will depend on its particular facts and circumstances.

EXAMPLE

Payments to employment agencies for staff are shown as apportionable on the basis the staff are required for activities that relate to both members and non-members. If, however, the activities only relate to:

- non-members, the payments are fully deductible
- members, the payments are non-deductible.

Description	Non-deductible	Deductible	Apportionable
Accounting fees (general)			✓
Administration costs			✓
Advertising expenses			✓
Annual general meeting expenses	✓		
Audit of accounts fees			✓
Bad debts			✓
Bank charges (investment account)		✓	
Bank charges (trading account)			✓
Bar expenses			✓
Board expenses			✓
Borrowing costs (mortgage on club's premises)			✓
Building write-off			✓
Cash shortages			✓
Cleaning costs			✓
Community benefit payments (if required by law)			✓
CDSE Scheme payments - NSW		✓	
Computer expenses			✓
Consultancy fees			✓
Contract, sub-contract and commission expenses			✓
Cost of managing tax affairs		✓	
Decline in value (depreciating assets) expenses			✓
Directors fees			✓
Donations to community organisations (not DGRs)	✓		
Donations to deductible gift recipients (DGRs)		✓	
Electricity costs			✓
Employee expenses (other)			✓
Employee leave payments			✓
Employee leave provisions	✓		

Description	Non-deductible	Deductible	Apportionable
Employee salaries and wages			✓
Employee superannuation		✓	
Employee training and welfare costs			✓
Employee uniforms			✓
Employees – pay out tips (non-voluntary)			✓
Employees – pay out tips (voluntary)	✓		
Employees – payroll taxes			✓
Employees – worker's compensation costs			✓
Employees amenities			✓
Entertainment expenses			✓
Filing fees			✓
Fines and penalties	✓		
Flowers and decorations			✓
Freight and cartage			✓
Gaming licenses (machines owned)			✓
Gaming machine commission expenses		✓	
Gaming machine expenses (owned or leased)			✓
Gaming taxes and levies (machines owned)			✓
Gas			✓
Guests and reciprocal members expenses		✓	
Hire of equipment/videos			✓
Hire of facilities for functions			✓
Honoraria paid to volunteers			✓
Insurance on club property			✓
Interest expense (mortgage on club's premises)			✓
Investment costs		✓	
Keno commission expenses		✓	
Land taxes		✓	
Laundry and dry cleaning			✓
Member discounts	✓		
Member loyalty schemes	✓		
Member magazine expenses	✓		
Member wreaths, flowers, hospital visits	✓		
Members birthdays	✓		
Members/badge draws	✓		
Membership subscriptions costs	✓		

Description	Non-deductible	Deductible	Apportionable
Motor vehicle expenses			✓
Payments to employment agencies for staff			✓
Payphone expenses (commission or agreed amount)		✓	
Payphone expenses (owned or leased)			✓
Permits, licences and fees			✓
Pest control			✓
Prepaid expenses			✓
Printing, stationery and postage expenses			✓
Prizes and trophies	✓		
Purchase of merchandise			✓
Raffle and bingo expenses			✓
Rates		✓	
Rent expenses and outgoings – club			✓
Rent expenses and outgoings – investment properties		✓	
Repairs and maintenance – club			✓
Repairs and maintenance – investment properties		✓	
Restaurant/bistro expenses			✓
Security costs			✓
Small business and general business tax break		✓	
Sponsorship costs		✓	
Stocktaking expenses			✓
Subscriptions to professional associations – first \$42		✓	
Subscriptions to professional associations (general)			✓
Sundry/general expenses			✓
TAB facilities commission expenses		✓	
Telephone expenses			✓
Waste disposal expenses			✓

➤ For worked examples of classifying expenses, see chapter 8.

➤ RECORD KEEPING

For information on what records to keep for expenses, see our web-only fact sheet *Record keeping in the pubs and clubs industry* and our publication *Tax basics for non-profit organisations* (NAT 7966).

- Choosing an apportionment method **page 31**
- Simple methods **page 31**
- Waratahs formula **page 32**
- Other methods **page 34**

Apportionment methods include:

- simple methods
- the Waratahs formula
- other methods.

CHOOSING AN APPORTIONMENT METHOD

Before choosing one or more methods, it is important that you correctly identify whether an individual is a member or non-member as the separation of the apportionable items relies on this accurate identification.

➤ For information on the meaning of 'member', see page 8.

Apportionment methods include:

- simple methods
- the Waratahs formula
- other methods.

The method (or methods) your organisation chooses must reasonably and accurately reflect its revenue and expenses.

An organisation may use one or more methods to separate its apportionable items for the year in question.

EXAMPLE

The Alizarin Society separates its apportionable items into member and non-member amounts using simple methods only – see case study 1 in chapter 8.

However, the Celadon Club uses both simple methods and the Waratahs formula to separate its apportionable items – see case study 2 in chapter 8.

SIMPLE METHODS

In many situations, it is easy to separate the apportionable items into member and non-member revenue. However, you may need to apportion expenses where you cannot identify the expenses as relating to either member or non-member.

EXAMPLES

Example 1

The Cerise Society holds monthly social events throughout the year. It sells tickets to the events to both members and non-members.

In the 2008–09 income year, the society recorded ticket sales of \$20,000. This represented 1,000 tickets at \$20 a ticket – 600 tickets were sold to members and 400 tickets were sold to non-members. The total cost of running the events was \$15,000.

The society separates its revenue and expenses for the events as follows. First, it determines the percentage that relates to non-members.

$$\begin{aligned}
 &= \frac{\text{number of non-member tickets sold}}{\text{total number of tickets sold}} \\
 &= \frac{400}{1,000} \\
 &= 40\%
 \end{aligned}$$

The society then applies this percentage to the events sales and costs to arrive at the assessable income and deductible expenses components.

$$\begin{aligned}
 &\text{Assessable income component} \\
 &= \$20,000 \times 40\% = \$8,000
 \end{aligned}$$

$$\begin{aligned}
 &\text{Deductible expenses component} \\
 &= \$15,000 \times 40\% = \$6,000
 \end{aligned}$$

These amounts are then added to any other assessable income or deductible expenses.

Example 2

The Cerulean Association derives revenue from members and from investments (rent and interest). Investment income is the only non-member income it derives.

In the 2008–09 year, the association's membership revenue totalled \$360,000 and its investment income totalled \$40,000.

The association also had expenses of \$30,000 (consisting of office supplies, rent, telephone and electricity expenses) which did not relate specifically to its membership revenue or its investment income.

To determine the deductible component of these expenses the association first determines its non-member percentage:

$$\begin{aligned} &= \frac{\text{investment income}}{\text{total revenue}} \\ &= \frac{40,000}{400,000} \\ &= 10\% \end{aligned}$$

The association then applies this percentage to the expenses to arrive at the deductible expenses component.

$$\begin{aligned} \text{Deductible expenses component} \\ &= \$30,000 \times 10\% = \$3,000 \end{aligned}$$

This amount is then added to any other deductible expenses.

WARATAHS FORMULA

Where the separation of apportionable revenue and expenses is more involved, you may choose to use the Waratahs formula.

The Waratahs formula is a base formula for isolating member and non-member contributions to income of an organisation, and it simplifies the process for separating expenses that cannot be easily identified as either member or non-member.

The formula comes from case law and takes its name from a case involving the Waratahs Rugby Union Football Club and the Commissioner of Taxation. The formula is accepted as a reasonable basis for apportionment, particularly for registered and licensed clubs.

! The Waratahs formula calculates the non-member percentage, which is then applied to the organisation's revenue and expenses to arrive at the assessable and deductible components.

The Waratahs formula is as follows:

$$\frac{(B \times 75\%) + C}{(R \times S \times T) + A}$$

Where:

A = total visitors for the year of income

B = members' guests for the year of income

C = A – B

R = the average number of subscribed members in the year of income

S = the average daily percentage of member attendance at the organisation

T = the number of trading days in the year of income

! Organisations must calculate their non-member percentage for each year of income, as the variables in the formula can change.

The Waratahs formula requires a figure for daily member attendance at the organisation as well as a visitor total for the year of income.

The formula also requires that members' guests be differentiated from other visitors.

Some organisations are required by state licensing laws to maintain separate registers for members' guests and visitors. However, these laws may not require organisations to keep records of member attendance.

Determining (A) total visitors and (S) average daily percentage of members attendance

The formula relies on the accuracy of visitor and member registers, and survey results.

Visitor and member registers

Where an organisation is required by state licensing laws to maintain a register, total visitors can be determined by summation of the visitors, temporary and honorary members' book(s).

Likewise, the average daily percentage of member attendance can be determined by summation of the members' daily attendance book(s).

! If an organisation does not have permanent door staff, a survey should be conducted.

Some registered clubs are allowed by state licensing laws to admit temporary members for an extended period of up to seven days, or up to 30 days with approval. Under these arrangements, when the person enters the club's premises for the first time they must sign the visitors' register. However, they do not have to sign in on subsequent visits. Where the club adopts this arrangement, it should count the temporary member as having been a visitor on each day of the period, unless the club records the person's actual attendance on the club's premises during this time.

Conducting surveys

If an organisation does not have records of total visitors and member attendance to include in the formula, it should conduct regular surveys of visitor and member attendance.

! If an organisation is required to conduct surveys, we recommend a minimum of two one-week surveys be done each year.

Because organisations have to take into consideration their own circumstances with regard to the variables used in the formula, surveys are needed to determine members' attendance instead of making assumptions.

Two one-week survey periods are acceptable, provided they are administered diligently.

The surveys should be conducted during periods that are likely to be representative of average trading periods – for example during autumn and spring months. School holiday periods may or may not be indicative of normal trading periods.

During the survey period, registered clubs that admit temporary members for an extended period should count the temporary member as a visitor on each day the person actually attends the club's premises.

The survey results may then be annualised in order to estimate total visitor attendance as well as the average daily percentage of member attendance for the year of income.

EXAMPLE

When entering the Persimmon Club, visitors are required to sign the visitors' book and members are required to show their member card.

The club determines the total visitors for the year by summation of the visitors' book.

To determine the average daily percentage of member attendance, the club conducts two one-week surveys. During each survey period, the club arranges for staff to attend the door and use a 'clicker' to count the members as they enter the club.

Arranging for staff to attend the door and use a 'clicker' to count the members as they enter the club is one method of conducting surveys. However, other methods can be used provided diligence is applied.

EXAMPLE

For the next survey period, the Persimmon Club leaves a number of survey questionnaires on its front counter. All people attending the club are encouraged to complete the survey. The survey questions cover a range of topics including the club's ambiance, food, drink, entertainment and pricing. One question in the survey is about the average daily percentage of members attending the club. The club uses the results from this question to determine the average daily percentage of member attendance.

In the following year, the club installs a membership swipe card reader. The club notifies its members that a survey will be conducted during the relevant period and asks that members ensure they swipe their membership card when they enter the club. To encourage members to register their attendance, the club runs lucky member draws during the survey period. The club uses the results from the swipe card reader to determine the average daily percentage of member attendance.

Determining (B) members' guests

Where an organisation is required by state licensing laws to maintain a register, the number of members' guests can be determined by summation of the register.

The Waratahs formula assumes that 75% of members' guests contribute to the organisation's assessable income. This is because the formula assumes that 25% of visitors do not spend money while in the organisation, because they are:

- members' spouses or friends whose expenses are paid by members
- people entertained by the organisation at the expense of the organisation.

Organisations should ensure that the 75% variable used in the formula is representative of their own circumstances.

WARATAHS FORMULA EXAMPLE

The Vermilion Club has a total of 10,000 visitors (A) who attend the club during the income year and 4,000 of these are members' guests (B). Therefore, (C) equals 6,000 being (A) minus (B).

The membership at the beginning of the year was 1,000 and at the end of the year it was 1,400. Therefore, the average number of members for the year was 1,200 (R).

Surveys done during the year have given an average daily member attendance of 10% (S). The club is open for 363 days during the year (T). During this time it recorded bar sales of \$52,000 and bar expenses of \$22,000.

The club calculates the portion of non-member income and deductions as follows:

$$= \frac{(B \times 75\%) + C}{(R \times S \times T) + A}$$

$$= \frac{(4,000 \times 75\%) + 6,000}{(1,200 \times 10\% \times 363) + 10,000}$$

$$= 16.80\%$$

The club then applies this percentage to its bar sales and bar expenses to arrive at the assessable income and deductible expenses components.

Assessable income component
= \$52,000 × 16.80% = \$8,736

Deductible expenses component
= \$22,000 × 16.80% = \$3,696

These amounts are then added to any other assessable income or deductible expenses.

OTHER METHODS


You may, for the purposes of calculating taxable income, adopt another method of apportionment where there is a reasonable basis to do so and provided it reasonably and accurately reflects your organisation's revenue or expenses for the year in question.

The method you choose is likely to depend on the type of revenue or expenses your organisation has.

Other methods include:

- the poker machine jackpot and credit payouts method
- the fixed percentage method.

Poker machine jackpot and credit payouts method

 This method is used in limited circumstances only. It may not be suitable for organisations that do not have many poker machines, or if the poker machines are not used frequently.

This method should only be used to apportion revenue and expenses that relate to poker machines. This is because it does not take into account the members and non-members who attend the organisation and do not play the poker machines.

This method uses poker machine payouts to members and non-members to arrive at a non-member percentage.

EXAMPLE

The Ecu Club owns and operates poker machines on its premises.

An examination of its records for the year shows 24 jackpot payouts to members totalling \$12,000 and 36 jackpot payouts to visitors totalling \$12,000. It also shows 96 credit payouts to members totalling \$24,000 and 144 credit payouts to visitors totalling \$72,000.

During the year it recorded gaming machine revenue of \$624,000 and gaming machine expenses of \$264,000.

The payout percentage is as follows:

= $\frac{\text{number of jackpot and credit payouts to visitors}}{\text{total number of jackpot and credit payouts}}$

= $\frac{180}{300}$


= 60%

The club would **only** apply the percentage to its gaming machine revenue and expenses to arrive at the assessable income and deductible expenses components. These amounts would then be added to any other assessable income or deductible expenses.

Fixed percentage method

This method is where an organisation has negotiated a percentage with the ATO. For example, an organisation applies for a private ruling and we advise them of the percentage to use.

A difficulty with this method is that it does not reflect changes that occur from year to year – for example an organisation's refurbishment or new legislation requirements.

 A private ruling only applies to the particular circumstances that it describes. If there is a material difference between the circumstances described and what actually occurs, the private ruling is ineffective.

Due to the variations between organisations' circumstances, it is not feasible for the ATO to prescribe one fixed percentage for use by all organisations.

- Capital gains tax **page 36**
- Consolidation for income tax purposes **page 39**
- Goods and services tax **page 39**
- Fringe benefits tax **page 41**
- State and territory requirements **page 43**

Capital gains tax (CGT) is a component of income tax. The operations of non-profit organisations may have CGT consequences.

Wholly owned corporate groups may have the option of consolidating for income tax. While a non-profit company can be the head company of a consolidated group, it cannot be a subsidiary member.

If your organisation provides a fringe benefit to its employees, it may have a fringe benefits tax (FBT) liability. Your organisation will need to distinguish between employees, volunteers and independent contractors.

Goods and services tax (GST) is a broad-based tax of 10% on the sale of most goods, services and anything else consumed in Australia. Some issues your organisation may need to consider are the effect of GST on:

- vouchers and gambling
- tips and gratuities
- taxable income.

State and territory governments levy stamp duty, payroll tax and land tax. They also have their own laws regulating fundraising activities of non-profit organisations.

CAPITAL GAINS TAX

Capital gains tax (CGT) is the tax a person or organisation pays on any capital gain it makes and includes in its annual income tax return. There is no separate tax on capital gains – it is just a component of income tax. An organisation is taxed on its net capital gain at the company tax rate.

An organisation's net capital gain	=	Total capital gains for the year	–	Total capital losses, including any net capital losses from previous years	–	Any CGT small business concessions
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➤ For detailed information on how to work out your organisation's net capital gain or net capital loss, refer to our publication *Guide to capital gains tax* (NAT 4151).

Some of the particular CGT issues that can affect a non-profit organisation include:

- the sale of assets used in carrying on its activities
- changes to the form of an organisation's incorporation
- the amalgamation of organisations
- the availability of CGT concessions such as the small business concessions.

When can an organisation make a capital gain or capital loss?

Generally, a capital gain or capital loss is made if a CGT event happens. Many CGT events are transactions that involve a CGT asset while other CGT events relate directly to capital receipts.

The most common CGT event (known as CGT event A1) happens if an organisation **disposes of an asset** to someone else – for example, it sells or gives away an asset. Examples of other CGT events are:

- the loss or destruction of an asset (the destruction may be voluntary or involuntary)
- the cancellation, surrender or redemption of shares
- the receipt of a payment for creating a right in another entity
- the receipt of a lease premium.

There is a summary of CGT events in the *Guide to capital gains tax* (NAT 4151).

⚠ There are special rules that apply when working out gains and losses from depreciating assets.

If you use a depreciating asset wholly for a taxable purpose, any gain you make on its disposal is treated as ordinary income and any loss as a deduction.

If a depreciating asset is used both for a taxable purpose and for a non-taxable purpose, a capital gain or capital loss may also arise on disposal. The amount of the capital gain or capital loss is the difference between the asset's cost and its termination value that is attributable to the use for a non-taxable purpose.

EXAMPLE

A non-profit society sells a computer for \$600. The computer's cost is \$1,000. It has been used 40% of the time for non-taxable member purposes. At the time of its sale, the computer's adjustable value is \$700.

A capital loss of \$160 arises. This is 40% (the non-taxable member proportion) of the difference between the computer's termination value and its cost.

In addition, the organisation can claim a deduction of \$60. This is 60% (the taxable or non-member proportion of use) of the balancing adjustment amount (the difference between the computer's termination value and its adjustable value at the time of its sale).

For depreciating assets that are used wholly for a non-taxable purpose, the difference between the asset's termination value and its cost can be a capital gain or capital loss.

For some depreciating assets, any capital gain or capital loss arising will be disregarded even though the asset is used for a non-taxable purpose.

➤ If your organisation has disposed of an asset that has been depreciated, refer to *Guide to depreciating assets* (NAT 1996).

Calculating a capital gain or loss

For a CGT event involving an asset, a capital gain or loss is broadly the difference between the amount paid for the asset and the amount received for it. In some cases, the amount paid or received for an asset is taken to be its market value. Incidental costs involved in acquiring and disposing of the asset, such as legal fees and commissions, can also be taken into account.

For other CGT events, a capital gain or loss is generally the difference between the amount received and the costs involved with the transaction.

If your organisation's total capital losses for the income year are more than its total capital gains, the difference is a net capital loss for the year. The net capital loss can be carried forward to later income years to be deducted from future capital gains.

Are pre-CGT assets taxed?

Generally, any capital gain or loss from an asset that was acquired before 20 September 1985 (pre-CGT assets) is disregarded.

What if the CGT asset was purchased with funds contributed by members?

Although an organisation's mutual receipts are not treated as assessable income, this does not mean that an asset purchased with those receipts is exempt from CGT.

EXAMPLE

An incorporated non-profit association owned a property purchased with contributions made by the members. The property was used and maintained as an administration centre to collect member subscriptions and to administer activities for the benefit of members.

A capital gain arising on sale of the property is not exempt from CGT.

Can the CGT discount apply?

The CGT discount (which enables some capital gains to be reduced by up to 50%) is not available to companies. As a non-profit club, society or association is treated as a company for tax purposes, the CGT discount cannot reduce any capital gain it may make. However, the small business 50% active asset reduction may apply – see below for more information.

Can the CGT small business concessions apply?

The CGT concessions a non-profit organisation may be entitled to are:

- the small business 50% active asset reduction – which reduces a capital gain by 50%
- the small business roll-over – which defers a capital gain for a minimum of two years if a replacement asset is acquired or expenditure is incurred in making improvements to existing assets.

To qualify, your organisation must first satisfy at least one of the following basic conditions:

- it is a small business entity
- it does not carry on business (other than as a partner) but its asset is used in a business carried on by a small business entity that is an affiliate or is connected with it (passively-held assets)
- it is a partner in a partnership that is a small business entity, and the CGT asset is:
 - its interest in a partnership asset (partnership assets), or
 - an asset it owns that is not an interest in a partnership asset (partner's assets)
- it satisfies the maximum net asset value test – the total net market value of the assets of your organisation and certain other entities are \$6 million or less just before the CGT event that results in the capital gain.

In addition, the asset must satisfy the active asset test.

➤ These concessions and their conditions are explained in detail in our publication *Guide to capital gains tax concessions for small business* (NAT 8384).

Do other CGT exemptions and roll-overs apply?

There are a range of exemptions and roll-overs that can reduce the amount of a capital gain or loss, or defer the capital gain or loss. Examples are:

- an exemption for cars and motor cycles
- roll-over if a statutory licence is renewed or extended
- roll-over if an asset is compulsorily acquired.

Exemptions and roll-overs may apply to your organisation if it meets the relevant conditions.

Are there CGT consequences if an organisation changes its status?

An organisation may be unincorporated, incorporated under the *Corporations Act 2001* or an equivalent foreign law, or incorporated under a law other than a company law – for example, the *Associations Incorporation Act 1981* (Qld).

If an unincorporated association incorporates, a CGT event may happen to each of the CGT assets that it owns because incorporation results in a change of ownership.

EXAMPLE

An unincorporated club bought a property in Brisbane in 1996. In February 2009, it incorporated under the *Associations Incorporation Act 1981* (Qld).

CGT event A1 happens to the property.

The unincorporated club will have made a capital gain if the market value of the property at the time exceeds the cost base of the property. The club will make a capital loss if the market value of the property is less than its reduced cost base.

If the unincorporated club owned assets that it acquired before 20 September 1985 (pre-CGT assets), the incorporated club will have acquired the assets for market value at the time of incorporation.

If an incorporated organisation changes the form of its incorporation, there may also be CGT consequences, depending on the relevant legislation. For example, incorporation under the *Corporations Act 2001* in certain circumstances does not create a new legal entity.

⚠ If your organisation changes status and you are unsure about the CGT consequences, you should seek advice from a professional adviser or us (see 'More information' on the inside back cover for contact information).

What about amalgamations and dissolutions?

There can be CGT consequences if organisations amalgamate.

For example, capital gains and losses may arise where two organisations merge to form a new organisation, or where one organisation is absorbed into another.

The CGT consequences resulting from amalgamations may differ depending on the state or territory in which the organisations are incorporated.

Similarly, the winding up of an organisation can result in capital gains and losses.

➤ For more information see:

- *Guide to capital gains tax* (NAT 4151)
- *Guide to capital gains tax concessions for small business* (NAT 8384).

CONSOLIDATION FOR INCOME TAX PURPOSES

Wholly-owned corporate groups may have the option of consolidating for income tax. Consolidation is optional but irrevocable. The consolidated group operates as a single entity for income tax purposes, lodging a single income tax return and then paying a single set of PAYG instalments.

When a group consolidates, it is a 'one in, all in' situation, in which all of the head company's eligible wholly-owned subsidiary members become part of the group.

The following entities (which receive special tax treatment compared with ordinary Australian-resident companies) cannot be a head company or subsidiary member of a consolidated group:

- exempt entities (that is, total ordinary and statutory income is exempt)
- pooled development funds
- film licensed investment companies
- certain credit unions.

Other entities specifically excluded from being a subsidiary member of a consolidated group are:

- non-profit companies
- trusts that are complying and non-complying superannuation entities
- trusts that are non-complying approved deposit funds.

While a non-profit company can be the head company of a consolidated group, it cannot be a subsidiary member.

➤ For more information on consolidation, refer to the *Consolidation reference manual*.

GOODS AND SERVICES TAX

Goods and services tax (GST) is a broad based tax of 10% on the sale of most goods, services and anything else consumed in Australia.

- ⚠ When we say:
- **sales** we are referring to the GST term **supplies**
 - **purchases** we are referring to the GST term **acquisitions**
 - **GST credit** we are referring to the GST term **input tax credit**
 - **payments made** or **payments received** we are referring to the GST term **consideration**, and
 - **annual turnover** we are referring to the GST term **GST turnover**.

GST is a tax on transactions. Where a non-profit organisation is registered (or required to be registered) for GST, it will be liable for GST on most sales of goods and services and anything else. Similarly, the organisation may be entitled to claim GST credits on the purchases it makes in carrying out its activities.

Registering for GST

If your non-profit organisation has an annual turnover of \$150,000 or more, it must register for GST.

If your organisation has an annual turnover of less than \$150,000, it can choose to register for GST. The decision to voluntarily register for GST should be made based on your organisation's administrative needs.

Generally, an organisation must then stay registered for at least 12 months, even if its annual turnover is less than \$150,000.

What does being registered for GST mean?

If your organisation is registered (or required to be registered) for GST, it generally includes GST in the price of most goods and services and anything else it sells.

Being registered for GST means that your organisation:

- must pay the GST on its sales to the ATO
- can claim GST credits for any GST included in the price of its business purchases
- must complete a business activity statement to report the taxable sales and claim GST credits.

➤ For more information about meeting your GST reporting obligations, refer to:

- *GST for small business* (NAT 3014)
- *GST tips for non-profit organisations*.

GST on vouchers

A voucher includes a voucher, token, stamp (but not a postage stamp), coupon or similar article, or prepaid phone card or facility that, when redeemed, entitles the holder to receive goods or services in accordance with its terms.

Broadly speaking, if you sell a voucher for its stated monetary face value and the holder is entitled to redeem it for goods or services up to that stated value, you do not account for the face value of the voucher on your activity statement until it is redeemed.

➤ For more information on the effect of GST on vouchers, refer to *GST and vouchers - completing your activity statement* (NAT 10815).

GST and gambling

Gambling includes:

- raffles
- lotteries
- gaming machines in clubs
- betting on racing and other events.

Gambling sales are taxable, but you only apply GST to your margin – not to individual gambling sales.

To work out your margin:

- work out the total amount you received in gambling event wagers for the tax period
- subtract the total monetary prizes you paid for the tax period.

If the total wagered amount you received is more than the total amount of monetary prizes you paid, you must pay GST of one-eleventh of this margin.

EXAMPLE

A GST registered non-profit organisation receives \$83,000 in bets through the gaming machines it owns and pays out \$50,000 in cash prizes in one tax period. The margin on the club's sales for GST purposes is \$33,000 (\$83,000 – \$50,000).

The club will need to pay \$3,000 GST ($\$33,000 \times 1/11$) on its gambling sales for this tax period.

You do not include the value of non-monetary prizes, such as a car, when you work out your margin. You can only deduct monetary prizes from the total amount wagered.

EXAMPLE

A GST registered non-profit organisation raffles a car and collects \$44,000 from ticket sales. As the car is not a monetary prize, the margin for holding the raffle would be \$44,000. The club will need to pay \$4,000 GST ($\$44,000 \times 1/11$) to the ATO.

If you receive a monetary donation that you use as a prize in a raffle or competition, you include the value of the prize in your margin.

If you receive a non-monetary donation that you use as a prize in a raffle or competition, you do not include the value of the prize in your margin.

➤ For more information, refer to *GST and gambling* (NAT 3018).

Lucky badge member draws

In a lucky badge member draw, a club member's registration/ membership number is drawn at random. If that member is present, they win a cash prize. If the member is not present, the prize jackpots by the cash amount until the prize is won in a later draw. Lucky badge member draws are only open to members. No tickets are purchased. Members simply have to be present when the draw is undertaken.

A lucky badge member draw is a gambling event because it is a contest where the outcome is determined by chance. The club will need to take into account monetary prizes given to members in calculating its margin when determining the GST liability of its gambling sales.

➤ For more information, refer to *GSTR 2002/3 Goods and services tax: prizes*.

'GST rebate' on gaming machines

The 'GST rebate' is a payment made to NSW clubs by the NSW Government to help the clubs with the impact of the GST on their gaming machine revenue. The payment is based on actual gaming profits for the previous three months and paid quarterly.

The 'GST rebate' is a result of an external party arrangement – that is, the memorandum of understanding between the NSW Government and Clubs NSW. Clubs do not have to separately register or make a claim for the payment as the information is collected using data matching.

The payment is not a reduction in a club's GST liability on its gaming machine revenue, because the GST law does not include a rebate on GST.

The 'GST rebate' is not a taxable supply as the clubs are not required to supply anything, do anything or enter into an obligation to do anything to obtain it. Therefore there is no GST payable on the payment.

GST on tips and gratuities

If your organisation is registered for GST and receives tips that are voluntarily paid, your organisation does **not** have to:

- pay GST on the tips it pays to its employees or contractors
- report the tips it pays to its employees or contractors as income on its activity statement.

If your organisation does not pay all of these tips to its employees or contractors, your organisation must:

- pay GST on the tips it keeps as its business takings
- report this income on its activity statement.

If your organisation is registered for GST and receives tips that are non-voluntary (for example, for a pre-set amount, a surcharge or a service charge), your organisation must:

- pay GST on these tips
- report this income on its activity statement.

➤ For more information, refer to *Tips and gratuities* (NAT 72667).

The effect of GST on taxable income

The effect of GST on the calculation of taxable income differs depending on whether your organisation is registered for GST, or is required to be registered.

Assessable income

If your organisation is registered for GST or is required to be registered, adjustments to assessable income may be needed to calculate the taxable income. Your organisation's assessable income will not include the GST payable on a taxable supply it makes.

EXAMPLE

A recreational association is registered for GST. It supplies equipment to non-members for \$220 per item. The price includes \$20 GST.

The association's assessable income would include \$200 for each item. The \$20 GST would not be included.

If your organisation is not registered for GST and is not required to be registered, no adjustment for GST is needed in calculating taxable income.

EXAMPLE

A social club is not registered for GST and not required to be registered. It supplies equipment to non-members for \$330 per item.

The club would include \$330 per item as assessable income.

Deductions

If your organisation is registered for GST or required to be registered, adjustments to deductions may be needed to calculate the taxable income. Your organisation's deductions will not include the GST credits to which your organisation is entitled.

EXAMPLE

A non-profit club is registered for GST. It buys goods for \$550 for a fundraising drive to non-members. It is entitled to a GST credit of \$50 on the purchase.

The club's deduction would be \$500. It cannot claim a deduction for the part of the purchase price that it can claim as a GST credit – in this case \$50.

If your organisation is not registered for GST and is not required to be registered, no adjustment for GST is needed in calculating taxable income.

EXAMPLE

A lobbying association is not registered for GST and not required to be registered. It buys goods for \$220 to help in deriving its assessable income. The \$220 included \$20 GST.

The association's deduction would be \$220.

Mutual receipts and GST turnover

While mutual receipts are not included in assessable income, they may be included in GST turnover.

Where a mutual receipt is related to an input taxed supply made by the supplier, it is not included in the GST turnover.

FRINGE BENEFITS TAX

Fringe benefits tax (FBT) is a tax payable by employers who provide fringe benefits to their employees or to associates of their employees. This is the case whether or not the employer is the actual supplier of the benefit (for example, where the benefit is provided by an associate or under an arrangement with a third party).

If your organisation provides a fringe benefit to its employees or to associates of its employees (typically family members), it may have an FBT liability. This is separate from income tax and is calculated on the taxable value of the fringe benefits provided.

What is a fringe benefit?

A fringe benefit is a 'payment' to an employee, but in a different form to salary and wages. Benefits include rights, privileges or services. For example, a fringe benefit may be provided when an employer:

- allows an employee to use a work car for private purposes
- gives an employee a cheap loan
- pays an employee's private health insurance costs.

Some employers, including non-profit organisations, will need to distinguish between employees, volunteers and independent contractors. For the purposes of FBT, an employee is a person who receives (or is entitled to receive) salary or wages, or a benefit that has been provided in respect of their employment. For example, an employee may be a company director. However, a volunteer is not paid for work. Reimbursing a volunteer for out-of-pocket expenses does not cause them to become an employee.

Generally, benefits provided to volunteers do not attract FBT. If an organisation provides non-cash benefits to workers in lieu of salary and wages, FBT can apply.

- For more information, refer to:
- *Fringe benefits tax for non-profit organisations*
 - *Volunteers and tax* (NAT 4612)
 - *Fringe benefits tax – a guide for employers* (NAT 1054).

Common fringe benefits

One of the most common fringe benefits is a car, which generally becomes a fringe benefit when it is owned or leased by an employer and made available for the private use of an employee. If the employer's car is garaged at an employee's house, it is treated as having been made available for private use.

Other common fringe benefits include:

- expense payments
- loans
- meals/entertainment
- housing.

Common exempt benefits

A number of benefits are exempt from FBT. These include:

- some taxi travel
- in-house health care facilities
- most minor benefits where the value of the benefit is less than \$300 and it would be unreasonable to treat it as a fringe benefit.

An FBT exemption applies for the following work-related items:

- a portable electronic device
- an item of computer software
- an item of protective clothing
- a briefcase
- a tool of trade.

The exemption is limited to:

- items primarily for work-related use
- one item per FBT year for items that have a substantially identical function, unless the item is a replacement item.

Registering for FBT

We recommend you register your organisation once you have established that it has to pay FBT.

Entertainment expenses

As an employer, you may, from time to time, provide your employees with food and drink and possibly leisure activities. This may happen in a variety of circumstances and in relation to a number of different employees and/or their associates. For example:

- Christmas parties
- business lunches
- birthday celebrations
- golf days
- planning conferences
- gym memberships
- breakfast meetings
- farewell functions
- reward and recognition functions
- memberships to sporting clubs
- anniversary dinners
- fundraising functions.

If you sometimes provide these events for your staff, you will need to know whether the events will be classified as entertainment and require you to pay FBT.

Tax-exempt body entertainment fringe benefits

A tax-exempt body entertainment fringe benefit may arise from entertainment expenses incurred by an employer who is wholly or partially exempt from income tax, or who does not derive assessable income from the activities to which the entertainment relates.

Your organisation is a tax-exempt body if your organisation's income is either:

- wholly exempt from income tax (for example, a club that earns income from members only), or
- partially exempt from income tax (for example, a club that earns income from both members and non-members).

There are only very limited circumstances under which an exemption will apply to the provision of food or drink.

- For common entertainment scenarios (such as meals provided to staff working shifts in hospitality) and whether an exemption applies, refer to *Fringe benefits tax (FBT) and entertainment for non-profit organisations*.

Depending on the standard of entertainment provided, the benefit may qualify for the minor benefits exemption. As well as the general criteria for deciding whether a minor benefit should be treated as an exempt benefit, for tax-exempt bodies the exemption is available only where:

- the provision of the entertainment is incidental to the provision of entertainment to outsiders and does not consist of a meal, other than light refreshments, or
- a function is held on your business premises solely as a means of recognising the special achievements of your employee in a matter relating to their employment.

In these circumstances only benefits provided to your employee, and their associates, are exempt from FBT.

EXAMPLES

Provision of light refreshment incidental to the provision of entertainment to outsiders

A tax-exempt body hosts a morning tea at a local café for its sponsors. Finger food, tea, coffee and soft drinks are provided. Some employees attend to thank the sponsors on behalf of the tax-exempt body for their assistance throughout a particularly difficult year. It is unusual for the tax-exempt body to host this type of function. The cost per head is \$15. Providing morning tea to employees in these circumstances would meet the requirements of the minor benefits exemption.

Function recognising special achievements of employee

A project manager, who is an employee of a tax-exempt body, is awarded 'Project Manager of the Year' by an external organisation. A dinner is held on the tax-exempt body's premises for the presentation of the award. Senior management of the tax-exempt body, the employee receiving the award and their family, and representatives from the external organisation presenting the award attend the dinner.

The minor benefits exemption applies in this circumstance to the employee receiving the award and their family.

The minor benefits exemption rule is unlikely to apply to any staff Christmas party provided by a tax-exempt body unless very limited circumstances apply.

Reportable fringe benefits

If the value of certain fringe benefits provided to your employees exceeds \$2,000 in an FBT year, you are required to record the grossed-up taxable value of those benefits on your employee's payment summary for the corresponding income year. This requirement applies even if your organisation is not liable to pay FBT.

➤ For more information, refer to *Fringe benefits tax (FBT) and entertainment for non-profit organisations*.

STATE AND TERRITORY REQUIREMENTS

Taxes that may be levied by state and territory governments include:

- stamp duty (or duty in Queensland and Victoria)
- payroll tax
- land tax.

Each state and territory has its own laws for these taxes – administered by its revenue office.

Enquiries about state and territory taxes should be directed to your local state or territory government authority – not the ATO.

➤ For more information, including contact details, refer to the 'State/territory government taxes and duties' chapter in our guide *Tax basics for non-profit organisations* (NAT 7966).

States and territories also have their own laws regulating the fundraising activities of non-profit organisations. The types of activities that are regulated include bingo, raffles and doorknock appeals.

As each state and territory has its own laws for these activities, you should direct any enquiries about state and territory regulations to the relevant authority in your area.

➤ For more information, including contact details, refer to the 'State and territory government requirements' chapter in our guide *Fundraising* (NAT 13095).

08

CALCULATING TAXABLE INCOME

- Case study 1 **page 44**
- Case study 2 **page 46**

The steps for calculating taxable income, as discussed in chapter 3, are:

- 1 Classify revenue
- 2 Classify expenditure
- 3 Separate the apportionable items
- 4 Calculate the taxable income

This chapter provides worked examples of how to calculate taxable income.

CASE STUDY 1

Facts

The Alizarin Society is a non-profit company with the following revenue and expenses for the year ended 30 June. It is not registered for GST and not required to be registered.

Revenue	\$	Expenses	\$
Membership subscriptions	\$3,000	Postage (see note 2)	\$100
Term deposit interest	\$800	Photocopying (see note 2)	\$100
Christmas dinner (see note 1)	\$5,000	Christmas dinner (see note 1)	\$4,000
Lamington sale to public	\$2,500	Cost of lamingtons	\$1,800
		Term deposit charges	\$50
Total	\$11,300		\$6,050

Note 1 The Christmas dinner was attended by 70 members and 30 non-members who paid \$50 each. It cost \$40 per person to cater for the dinner.

Note 2 From an examination of the society's records, 10% of its communication during the year was with non-members.

Steps for calculating taxable income

STEP 1: Classify revenue

Revenue	Non-assessable	Assessable	Apportionable	Total
Membership subscriptions	\$3,000	-	-	\$3,000
Term deposit interest	-	\$800	-	\$800
Sale of lamingtons	-	\$2,500	-	\$2,500
Christmas dinner	-	-	\$5,000	\$5,000
Total	\$3,000	\$3,300	\$5,000	\$11,300

STEP 2: Classify expenses

Expenses	Non-deductible	Deductible	Apportionable	Total
Postage	-	-	\$100	\$100
Photocopying	-	-	\$100	\$100
Christmas dinner	-	-	\$4,000	\$4,000
Cost of lamingtons	-	\$1,800	-	\$1,800
Term deposit charges	-	\$50	-	\$50
Total	-	\$1,850	\$4,200	\$6,050

STEP 3: Separate the apportionable items

Revenue	Non-assessable	Assessable	Total
Christmas dinner (see note 3)	\$3,500	\$1,500	\$5,000

Note 3 Revenue from the Christmas dinner is apportioned on the basis that it was attended by 70 members and 30 non-members who paid \$50 each.

Expenses	Non-deductible	Deductible	Total
Christmas dinner (see note 4)	\$2,800	\$1,200	\$4,000
Postage (see note 5)	\$90	\$10	\$100
Photocopying (see note 5)	\$90	\$10	\$100
Total	\$2,980	\$1,220	\$4,200

Note 4 Expenses for the Christmas dinner are apportioned on the basis that it was attended by 70 members and 30 non-members and it cost \$40 per person to cater for the dinner.

Note 5 Expenses for postage and photocopying are apportioned on the basis that 10% of Alizarin Society's communication during the year was with non-members.

STEP 4: Calculate the taxable income

Assessable income (\$3,300 + \$1,500)	\$4,800
Less: deductible expenses (\$1,850 + \$1,220)	\$3,070
Taxable income	\$1,730

➤ As its taxable income is more than the taxable threshold, the Alizarin Society will need to lodge a company tax return. For information on how to complete the company tax return, refer to our publication *Guide to company tax return for non-profit organisations* (NAT 73512).

CASE STUDY 2

Facts

The Celadon Club provides licensed facilities to its members and the general public. It also provides assistance to community and sporting organisations by way of donations.

The club is incorporated in the Australian Capital Territory under the *Associations Incorporation Act 1991*. Its constitution contains clauses prohibiting it from making any distribution, whether in money, property or otherwise, to its members.

The club's facilities include a bar, restaurant and function room. It also has poker machines (which it owns), Keno and TAB.

The club contracts with an external catering company to undertake the operation of the restaurant. Under the contract, the club receives lease payments and the caterer is responsible for all catering, including kitchen and waiting staff.

The club hires out its function room to the public. It also uses the function room for its own events such as Valentine's Day and Melbourne Cup luncheons.

The club has 5,000 members. A register is kept at the door which records member and non-member attendance. During the income year ended 30 June, 50,000 visitors entered the premises, including 43,000 guests who were signed in by members. The club traded for a total of 360 days during the year, and on average 250 members attended the club every trading day.

The club is registered for GST. Its revenue and expenses are shown net of GST, except where the amount of GST incurred is not recoverable from the ATO.

The club's financial statements for the year ended 30 June show the following revenue and expenses:

Revenue	
Bar sales	827,695
Bingo and raffle income	23,496
Club luncheons – ticket sales	22,500
Function room hire	6,000
Interest received	54,322
Keno commissions	46,152
Lease income – restaurant	10,000
Member subscriptions	51,800
Poker machine revenue – gross net of payouts	1,598,247
TAB commissions	18,421
Vending machine commissions	21,467
Total	\$2,680,100

Expenses	
Accounting – general	7,000
Accounting – management of tax affairs	3,000
Audit	5,000
Advertising	18,461
Bank charges	1,927
Bar expenses:	
– Cost of goods sold	392,576
– Decline in value (depreciating assets)	13,592
– Maintenance and supplies	29,764
Bingo expenses	4,533
Cleaning	45,000
Club luncheons – catering expenses	13,500
Club luncheons – entertainer expenses	3,000
Computer expenses	9,664
Decline in value (depreciating assets)	121,498
Directors expenses and honoraria	19,712
Donations to deductible gift recipients	12,869
Electricity	82,478
Insurance	48,192
Gaming machine expenses:	
– Gaming machine tax	210,969
– Payments to community organisations	13,786
– Repairs and maintenance	36,438
– Decline in value (depreciating assets)	262,481
– Central monitoring service charges	26,183
Keno expenses	2,157
Members magazine	8,000
Membership cards	2,000
Payroll tax	9,586
Printing, stationery and postage	22,544
Raffle expenses	24,851
Rates and land taxes	19,688
Repairs and maintenance	86,563
Salaries and wages	728,547
Pay TV	21,665
Subscription expenses	9,226
Superannuation	66,499
TAB expenses	3,661
Telephone	15,297
Total	\$2,401,907
NET PROFIT	\$278,193

Steps for calculating taxable income

STEP 1: Classify revenue

	Non-assessable income	Assessable income	Apportionable revenue	Total
Bar sales			827,695	827,695
Bingo and raffle income			23,496	23,496
Club luncheons – ticket sales			22,500	22,500
Function room hire		6,000		6,000
Interest received		54,322		54,322
Keno commissions		46,152		46,152
Lease income – restaurant		10,000		10,000
Member subscriptions	51,800			51,800
Poker machine revenue			1,598,247	1,598,247
TAB commissions		18,421		18,421
Vending machine commissions		21,467		21,467
Total	\$51,800	\$156,362	\$2,471,938	\$2,680,100

STEP 2: Classify expenses

	Non-deductible expenses	Deductible expenses	Apportionable expenses	Total
Accounting – general			7,000	7,000
Accounting – management of tax affairs		3,000		3,000
Audit			5,000	5,000
Advertising			18,461	18,461
Bank charges			1,927	1,927
Bar expenses:				
– Cost of goods sold			392,576	392,576
– Decline in value (depreciating assets)			13,592	13,592
– Maintenance and supplies			29,764	29,764
Bingo expenses			4,533	4,533
Cleaning			45,000	45,000
Club luncheons – catering expenses			13,500	13,500

STEP 2: Classify expenses *(continued)*

Club luncheons – entertainer expenses			3,000	3,000
Computer expenses			9,664	9,664
Decline in value (depreciating assets)			121,498	121,498
Directors expenses and honoraria			19,712	19,712
Donations to deductible gift recipients		12,869		12,869
Electricity			82,478	82,478
Insurance			48,192	48,192
Gaming machine expenses:				
– Gaming machine tax			210,969	210,969
– Payments to community organisations			13,786	13,786
– Repairs and maintenance			36,438	36,438
– Decline in value (depreciating assets)			262,481	262,481
– Central monitoring service charges			26,183	26,183
Keno expenses		2,157		2,157
Members magazine	8,000			8,000
Membership cards	2,000			2,000
Payroll tax			9,586	9,586
Printing, stationery and postage			22,544	22,544
Raffle expenses			24,851	24,851
Rates and land taxes		19,688		19,688
Repairs and maintenance			86,563	86,563
Salaries and wages			728,547	728,547
Pay TV			21,665	21,665
Subscription expenses	9,226			9,226
Superannuation		66,499		66,499
TAB expenses		3,661		3,661
Telephone			15,297	15,297
Total	\$19,226	\$107,874	\$2,274,807	\$2,401,907

STEP 3: Separate the apportionable items

Revenue	Non-assessable	Assessable	Total
Bar sales	595,609	232,086	827,695
Bingo and raffle income	16,908	6,588	23,496
Club luncheons – ticket sales	18,000	4,500	22,500
Poker machine revenue	1,150,099	448,148	1,598,247
Total	\$1,780,616	\$691,322	\$2,471,938

Club luncheons

The club held three special event luncheons during the year (Valentines Day, Melbourne Cup and Christmas Day). The ticket price to attend each event was \$50. The club apportions the revenue from the luncheons on the basis that a total of 450 tickets were sold to the events – 360 tickets to members and 90 tickets to non-members. The non-member percentage to apply using this method is $90/450 = 20\%$.

Other revenue items

The club regularly attracts members of the public, making it difficult to identify and separate its other revenue items. The club apportions these items using the Waratahs formula as follows:

The percentage of members who attend on a daily basis is 5%, or 250 members on average who attend on a daily basis divided by 5,000 memberships. The total number of visitors for the year was 50,000, which included 43,000 members' guests – that is, visitors signed in by members.

After putting in the figures, the non-member percentage to apply using the Waratahs formula is 28.04%.

$$\frac{(B \times 75\%) + C}{(R \times S \times T) + A} = \frac{(43,000 \times 0.75) + 7,000}{(5,000 \times 0.05 \times 360) + 50,000} = 0.2803571 \text{ or } 28.03571\%$$

Expenses	Non-deductible	Deductible	Total
Accounting – general	5,037	1,963	7,000
Audit	3,598	1,402	5,000
Advertising	13,285	5,176	18,461
Bank charges	1,387	540	1,927
Bar expenses:			
– Cost of goods sold	282,498	110,078	392,576
– Decline in value (depreciating assets)	9,781	3,811	13,592
– Maintenance and supplies	21,418	8,346	29,764
Bingo expenses	3,262	1,271	4,533
Cleaning	32,382	12,618	45,000
Club luncheons – catering expenses	10,800	2,700	13,500
Club luncheons – entertainer expenses	2,400	600	3,000
Computer expenses	6,954	2,710	9,664
Decline in value (depreciating assets)	87,430	34,068	121,498
Directors expenses and honoraria	14,185	5,527	19,712
Electricity	59,351	23,127	82,478
Insurance	34,679	13,513	48,192
Gaming machine expenses:			
– Gaming machine tax	151,813	59,156	210,969
– Payments to community organisations*	9,920	3,866	13,786
– Repairs and maintenance	26,221	10,217	36,438
– Decline in value (depreciating assets)	188,881	73,600	262,481
– Central monitoring service charges	18,841	7,342	26,183
Payroll tax	6,898	2,688	9,586
Printing, stationery and postage	16,223	6,321	22,544
Raffle expenses	17,883	6,968	24,851
Repairs and maintenance	62,291	24,272	86,563
Salaries and wages	524,262	204,285	728,547
Pay TV	15,590	6,075	21,665
Telephone	11,008	4,289	15,297
Total	\$1,638,278	\$636,529	\$2,274,807

* These payments are required under a state law. The law requires clubs holding gaming machine licenses to make payments from their gaming machine revenue to community organisations at a rate prescribed by the state. For this year, the club made cash payments that met, but did not exceed, the prescribed rate.

Club luncheons

The club held three special event luncheons during the year (Valentines Day, Melbourne Cup and Christmas Day). Catering was through the club's contract caterer at a cost of \$30 a head. The club apportions the cost of the luncheons on the basis that a total of 450 tickets were sold to the events – 360 tickets to members and 90 tickets to non-members. The percentage to apply using this method is $90/450 = 20\%$. This percentage would also apply to other costs associated with the club luncheons – that is, the entertainer expenses.

Other expense items

The club regularly attracts members of the public, making it difficult to identify and separate its other expense items. The club apportions its other expense items using the Waratahs formula. The percentage to apply using the Waratahs formula is 28.04% (as calculated in 'Other revenue items' on page 49).

STEP 4: Calculate the taxable income

Assessable income (\$156,362 + \$691,322)	\$847,684
Less: deductible expenses (\$107,874 + \$636,529)	\$744,403
Taxable income	\$103,281

➤ As its taxable income is more than the taxable threshold, the Celadon Club will need to lodge a company tax return. For information on how to complete the company tax return, including a worked example that uses the figures from case study 2, refer to our publication *Guide to company tax return for non-profit organisations* (NAT 73512).

MORE INFORMATION

PUBLICATIONS

To obtain copies of our publications:

- visit our website at www.ato.gov.au/nonprofit
- phone **1300 720 092**
- write to us at

Australian Taxation Office
PO Box 9990
PENRITH NSW 2740

General overview information

Tax basics for non-profit organisations (NAT 7966) provides an overview of tax obligations and concessions for all non-profit organisations. It helps you identify which taxes affect your organisation including income tax, fringe benefits tax (FBT), goods and services tax (GST) and pay as you go (PAYG).

More detailed information

Guide to company tax return for non-profit organisations (NAT 73512) is for taxable non-profit clubs, societies and associations. It:

- helps these organisations complete the company tax return
- explains some common errors and their consequences for these organisations when completing related labels.

Income tax guide for non-profit organisations (NAT 7967) explains:

- how to work out if your non-profit organisation is exempt from income tax
- the endorsement process for charities and income tax exempt funds.

GiftPack (NAT 3132) is for organisations that want to receive tax-deductible gifts and donors that want to claim deductions for their gifts.

Volunteers and tax (NAT 4612) explains the tax treatment of transactions that commonly occur between non-profit organisations and their volunteers.

Fundraising (NAT 13095) explains the tax treatment of various fundraising activities and the concessions available.

Other guides are available with detailed information on GST, PAYG withholding, FBT, superannuation, capital gains tax, activity statements and record keeping.

We also have a range of fact sheets on specific topics written especially for non-profit organisations.

Technical information

If you are looking for technical information such as rulings, practice statements and tax laws, you can find them on our website.

SERVICES

Internet

Our website includes an area specifically for non-profit organisations. The Non-profit organisations home page at www.ato.gov.au/nonprofit links you to information about:

- taxes relevant to non-profit organisations, including income tax, FBT, GST and PAYG
- exemptions or concessions that may apply
- other issues, such as fundraising, record keeping, volunteers and deductible gifts.

Email update service

Use the **Subscribe** link on our home page to subscribe to the Non-profit organisations webspace and receive free email updates when information is updated or added, including articles from the **Non-profit news service**. This will keep you up-to-date on:

- key tax issues affecting the non-profit sector
- new publications we release for non-profit organisations
- changes to tax law.

Education programs

Subject to availability, we have experienced tax officers who can deliver a variety of informative and practical tax presentations and workshops. To discuss requirements for your meeting, seminar or function, phone **1300 130 282** or email speakersandseminars@ato.gov.au

Phone

Phone our information line on **1300 130 248** for help with matters specific to non-profit organisations including the endorsement process for charities and deductible gift recipients, income tax, GST and FBT concessions.

If you do not speak English well and want to talk to a tax officer, phone the Translating and Interpreting Service on **13 14 50** for help with your call.

If you have a hearing or speech impairment and have access to appropriate TTY or modem equipment, phone **13 36 77**.

If you do not have access to TTY or modem equipment, phone the Speech to Speech Relay Service on **1300 555 727**.

Mail

Write to us at:

Australian Taxation Office
PO Box 3000
PENRITH NSW 2740

