

Table of Contents

IS IT ORDINARY INCOME?	1
FEATURES OF ORDINARY INCOME	1
PREREQUISITES OF ORDINARY INCOME	1
FINAL CHECK	2
FROM SERVICES	2
SALARY AND WAGES	2
ALLOWANCES	2
GIFTS & VOLUNTARY PAYMENTS (INCLUDING BONUSES)	2
TIPS	4
COMPETITION PRIZE *NOTE RELATION TO BUSINESS ALSO	4
CAPITAL INCOME FROM SERVICES	4
SUPERANNUATION	4
FREQUENT FLYER POINTS	4
FROM BUSINESS	5
1. IS THERE A BUSINESS OR A HOBBY?	5

Is it Ordinary Income?

Ordinary Income is income according to ordinary concepts: S 6-5(1)

If you are an Australian resident, your AI includes the OI you derive directly or indirectly from all sources, whether in or out of Australia, during the income year: S 6-5(2)

“Determined in accordance with the ordinary concepts and usages of mankind” **Scott (1935)**

Features of ordinary income

- Sufficient nexus with an income-earning activity (business, services, or property)*
 - Can still have ordinary income with no source
 - Government payments are OI because regular and expected and depended upon by TP: **Keily (1983); Dixon (1952)**.
- NOT a capital gain*
 - Can't be one-off: **Eisner v Macomber (1920)**.

Prerequisites of ordinary income

- Must be money or convertible to money:*

Must be readily convertible to cash: **Tennant v Smith 1892** (free rent not ordinary income due to restricted use); **Cooke & Sherden 1980** (non-transferable holiday not OI).

 - Failed?**
 - Is there a business? Does s 21A apply?**
 - A non-cash business benefit that is not convertible to cash shall be treated as if it were convertible to cash: s 21A(1)
 - It must be provided in respect of a business relationship: s 21A(5).
 - Does s 15-2 apply?**
- Must be a realised gain: Eisner v Macomber (1920)*
- Must be from an external source: Tennant v Smith (1892)*
- Must be a real gain and provide benefit to the TP: Countess of Bective (1932); Hochstrasser (1960)*
 - Reimbursements represent no real gain.

However, constructive receipt rule (s 6-5(4)) - if an amount is dealt with as per your directions, it is your income. Overcomes not being a 'real gain'.

Given that the prerequisites of income are satisfied, it is more likely that a benefit will be OI if it is periodic, regular and recurrent: **FCT v Harris (1980); FCT v Blake (1984)**

Final Check

- **Characterised in the hands of the taxpayer:** Federal Coke (1977)
 - Good example. Payment to subsidiary was income – Court said in Federal Coke’s perspective, it was just a gift as not income for the subsidiary. Commissioner should have used constructive receipt rule, as it was dealt with by Bellambi’s request.
- **Illegal payments** are still assessable income: La Rosa (2003)
- **Principle of mutuality:** you cannot pay yourself income – treated as NANE under s 6-23; RACV (1973)
- **Compensation payments:** *Dixon (1952)*
 - Take on the character of what they are replacing. House burnt down -> compensation payment for value of house. If sold house, it would’ve been capital gain so compensation payment would also be a capital gain (took on character of house).

From services

Salary and wages

- Salary or wages are specifically excluded from the definition of “fringe benefit” under s 136(1)(f) FBTA.
- Satisfies the pre-requisites of ordinary income and is income from services as there is a clear nexus between the services and the payment: Hayes; Scott. It is therefore ordinary income s 6-5 and assessable income s 6-1.
 - Note constructive receipt rule s 6-5(4) – if an amount is dealt with as per TP’s instructions, it is deemed to be TP’s income

Allowances

- Allowance is classified as salary and wages, and thus excluded from the definition of FB under s136(1)(f) FBTA.
- Allowance is predetermined amount made to cover an **estimated expense** which is paid regardless of whether that expense is incurred: RTA Case (1993); ATO TR 92/15
 - Thus is a real gain and satisfies prerequisites of ordinary income.
- Reimbursement is compensation made with direct reference to exact amount of expenditure incurred.
 - Reimbursement is FB and subject to FBT
- It is ordinary income (s 6-5) and thus assessable income (s 6-1) but can also be assessable under s 15-2 as statutory income. Note manifestation of contrary intention in s 15-2(3)(d) overriding s 6-25(2). Thus included in AI as OI.

Gifts & voluntary payments (including bonuses)

In Laidler v Perry, the court found that despite being voluntary, a payment that arises out of employment would be ordinary income.

Benefits from a 3rd party are income where it is a clearly recognised incident of employment: Scott; Kelly; Holmes
Compared to gifts, which are not connected to services and do not constitute ordinary income.

Determining whether XXX is a gift requires looking at various factors. No single factor is necessarily decisive, and they have been explored through past cases.

<p>Is there another relationship between the TP and provider (donor)? Scott (yes), Brown (no), Smith (no), Laidler v Perry (no) Yes = more likely to be gift</p>
<p>Is the benefit periodic, regular and regular? Harris (lump sum, gift), Blake (every 2 weeks, OI) Yes = more likely to be OI</p>
<p>Is donor grateful for services by TP? Holmes (yes), Brown (yes), Hayes (no – many years ago) Yes = more likely to be OI</p>
<p>*Has TP otherwise been adequately remunerated for their services? Scott (yes), Brown (no, wasn’t otherwise paid) Yes = more likely to be gift</p>
<p>Did other employees receive a bonus? Smith (yes – some received it), Laidler v Perry (yes – everyone received it) Yes = more likely to be OI</p>
<p>Did the benefit arise in context of employment? Scott (yes)</p>

Yes = more likely to be OI
Is benefit a common incidence of TP's employment? Scott (no) Yes = more likely to be OI
Did TP solicit (ask for) the benefit? Scott (no), Hayes (no) Yes = more likely to be OI
Motive of the donor (was it intended as a gift)? Dixon (no), Hayes (motive was gift) Intended as gift = more likely gift (however this is not decisive according to the courts)

Based on the above analysis, the payment is income as there is a nexus between benefit and services provided, thus assessable as ordinary income under s 6-5.

Based on the above analysis, the payment is a gift and thus not assessable as ordinary income

Scott (1966):

- **(Characteristics of personal gift)**
- It is a gift, Not OI
- Otherwise properly remunerated for service provided
- Relationship: Friends (More likely a gift). Also donor made other gifts at the same time -> Gift.
- Did the TP ask for the benefit? No.
- Common incident for the occupation? No, accountant

Brown (2002):

- **(Property received, as a reward for service was assessable)**
- Did not receive payment for service provided
- Get \$1m apartment from the developer in appreciation
- Not paid for this service
- No other relationship: More likely an income
- Common incident for the occupation: Yes, Agent
- Can be traced to some activity by the recipient for which the provider is grateful? Yes

Laidler v Perry (1965):

- **(Christmas bonus was OI)**
- Vouchers given to all employees for Christmas
- Provided regardless of pay rate/performance
- No other relationship: only employers and employees relationship
- More likely an income; "Benefit arose out of employment because it did not arise out of anything else"

Smith (1987):

- **(Employee receipt from employer as reward for studying assessable)**
- Employee of Westpac Bank
- Policy to provide all employees a payment if they successfully complete a course
- TP did course and received payment
- Payment = gift or income?
- Any other relationship? No.
- Employer & Employee relationship
- Smith was only eligible for the scheme by being employee
- Income and assessable

Hayes (1956):

- **(Characteristics of a gift)**
- Account help client to set up the company
- Buy shares of Client Company & sell back to them on request
- Years later, company became listed & gave accountant the shares
- Value of share: income or gift?
- Gift. - Did not ask for the share: so more likely a gift
- Whether the benefit can be traced to anything that he was grateful? No, was given years later
- Motive of Donor: client gives in the context of gift (Not a strong factor)

Holmes (1995):

- **(Receipt of reward money for helping to prevent was assessable)**
- Work in rescue ship to save people & ship on distress
- Receive reward from 3rd party who was saved in one of the operation
- Reward: income or gift?
- Receive benefit in the course of his employment? Yes.
- Smthg that he did that provider is grateful? Yes
- Would not have received payment if it was unsuccessful therefore nexus to services and assessable

Dixon (1952):

- **(Compensation for loss salary)**
- During WWII, employer volunteer to pay TP the difference between current pay and serving he military
- No expectation for him to come back and work
- High court states that top up payment = income
- Payment was paying for his military income - Recurrence payment: makes it a stronger point that it is an income

Harris (1980):

- **(Payments to retired employee to help reduce effect of inflation on pension payments)**
- Received a one-off payment
- As a pension top-up to counter the effects of increasing inflation
- Court state it is not a product of his past employment and therefore not OI

Tips

Tips are assessable income as they are made because of the level of service provided and not for any other reason, establishing the nexus with the service – making them assessable as OI under s 6-5: Penn (1908); Great Western Railway Co (1918); Calvert (1947).

Competition prize *note relation to business also

Not income unless taxpayer carrying on a related business or prize directly related to taxpayer's employment or extensive personal exertion and skill

- Carrying on a **related** business: Stone (2005); IT167
 - Stone was a world-class athlete had sponsorship deals, prizes and grants. Business in relation to sporting activities, even without a profit-motive due to other factors.
- Prize directly related to the employment: Kelly (football player, received prize on football show, only received prize due to being footballer)
 - **If prize indirectly related to employment look at gift versus income factors.**
- Extensive personal exertion and skill: Kelly; IT167
 - The level of personal exertion sufficient to turn a prize into OI is a question of degree

Radio and TV prizes – IT167 (to be OI, must be a result of business activity or degree of exertion and skill exceeds degree of luck)

- Member of general public participates casually and wins does not have the character of income
- Big Brother, Australian Idol, Masterchef = OI due to exertion (2nd requirement)
- Footballer winning footballer of the year = OI (directly related to employment) (3rd requirement)

Capital income from services

Provision of knowledge: Brent (1971)

- Brent was paid for her service of telling the story; she was not giving up a capital right.
- Always OI as knowledge is not owned.

Compensation payments: Phillips; Bennett (1947)

- Recall: compensation payments take on the character of what they're replacing (i.e. if they're replacing income, they're income)
- Phillip: lost concert fees due to injury – OI as it replaces salary
- Bennett: received compensation for giving up right to control the company thus capital.
- **If payment is for loss of control (or rights) then it is capital in nature: Bennett (1947)**

Restrictive covenants:

- Depends on whether the payment is connected with the current employment agreement (OI) or whether it is a separate agreement to give up valuable rights (capital)
- **Where the restrictive covenant is used as a part of the normal employment contract it will be ordinary income as it is generally viewed as a payment for future services: Higgs**
 - **Higgs:** Gave up acting rights for 18 months AFTER completing film – capital
- Giving up a right is generally capital in nature: Higgs; Woite
 - **Woite:** Signed contract to not play for any other team – however he never played for the team that gave him the contract. Therefore it was capital. If Woite played for them, it would likely be OI

Sign-on fees: Jarrold v Boustead (CS 6.14);

- Depends whether payment for future services or payment separate agreement to give up rights
- Pickford (1998): OI because it enticed to take up employment with another firm (i.e. for future services)
- **Sign-on fees are ordinary income as long as they are common incident of profession: TR 1999/17; Pickford v FCT (1998)**

NB: Capital in services context can be caught by s 15 -2

BUT CGT Event D1 has the same outcome: AAT Case 7752 (1992)

Superannuation

- Not a FB: s 136(1)(i)
- Not assessable income when paid into Superannuation fund
- Tax consequences arise when withdrawn

Frequent flyer points

- Not a FB:
- Not assessable income (no need to test for statutory): Payne; TR 1999/6

- Not OI because not convertible
- Not SI because no employer-employee relationship

From business

Income earned from carrying on a business is ordinary income under s 6-5 ITAA97 and expenditure is deductible. Income from a hobby does not generate ordinary income and expenditure is not deductible.

1. Is there a business or a hobby?

If it is a one-off, skip to isolated transaction

A business is “any profession, trade, employment, vocation or calling, but ... **not** ... o