

TAX LAW TEMPLATES

TOPIC 2: ASSESSABLE INCOME

Taxable Income = Assessable Income – Assessable Deductions

Assessable Income is pursuant to Div 6 of the ITAA97 comprises of:

1. Ordinary Income: s6-5
2. Statutory Income: 6-10
3. Exempt income is NOT assessable income

ORDINARY INCOME

- Ss6-5, 6-10 – resident taxpayer must pay tax on income from all sources
- S6-5(1) ordinary income includes 'income according to ordinary concepts':

Scott v FC of T

PREREQUISITES:

If it does not meet the two prerequisites it will NOT BE ORDINARY INCOME

1. It must be cash or cash convertible: s6-5; *FCT v Cooke and Sherden*
2. There must be a real gain, something valuable for the recipient:

Hochstrasser v Mayes

DETERMINING ORDINARY INCOME: *Eisner*

- Periodical and regular gains usually have the character of income: *Dixon; Federal Coke; Blake*
- Income is to be judged from the character in the hands of the recipient: *GP International Pipecoaters*

CATEGORIES OF INCOME

Ordinary Income has generally be held to include 3 categories

1. Personal Services
2. Income from property and
3. Income from carrying on a business

INCOME:

1. INCOME FROM PERSONAL SERVICES (individuals not business)

- One off payments for the provision of services have the character of income: *Dean; Hayes; Scott; Kelly*
- An amount will be ordinary personal exertion income if it is a product or incident of employment; however if there is a nexus between services provided, it should be assessed as OI: *Brown v FCT*
- There must be a sufficient nexus with labour: *Moorhouse v Dooland*
- a. **GIFTS** unrelated to employment, services or business are not income: *Hayes; Scott v FCT*
 - Receipts received as gifts are not earned and therefore not in ordinary concepts: *Scott v FCT*
 - Christmas bonus is income as voucher could be redeemed for goods and arose out of employment: *Laider v Perry*
 - Gifts of exceptional kind, not such as are common incident of a mans occupation, do not ordinarily form part of their income: *Scott v FCT* (lawyer gifted 10,000 pounds)
- b. **WINDFALL GAINS** will not be ordinary income unless they are earned as a result of income producing activities

- **Prizes:** that are income are those for professional sportsmen and women (ie sponsorship), are commonly held to be income: *Kelly v FCT*
 - **Gambling:** Winnings of gamblers will be a windfall gain unless the gambler is in the business of gambling: *Prince v FCT*
 - Courts reluctant to elevate activities of gambler to status of business: *Evans v FCT*
 - Windfalls are a product of luck and not of employment, service or business (ie lottery, punting, gambling); not income: *Babka*
 - **Quiz Show Contests** – not normally result in the derivation of income because activity does not amount to a business
- c. **CAPITAL RECEIPTS are not income: *DC of T v DP Smith***
- If receipt is regular = income; if it is once-off = capital
 - **Restrictive Covenants:** Where RC operates outside the employment period of TP any amounts received are treated as capital, as compensation for the loss of the right to work: *Higgs v Oliver*
 - *FCT v Woite*: Paid \$10k to not play footy for another club. Was giving up capital right to work; thus capital receipt
 - *Bennet v FCT*: Relinquishing employment rights and losing right to control company; remuneration earned is capital
 - *Brent v FCT*: Paid to disclose story about criminal husband. Was not giving up right to work. Earnings were OI as it was money for personal service (her telling the story)

2. INCOME EARNED FROM CARRYING ON A BUSINESS

Earnings from business activities are income in ordinary concepts. In contrast to non-business activities (hobby, pleasure activity, transactions of the business that are not business related)

- a. **FIRST: Identify whether a business is being carried on; *Stone v FCT***
- Business defined: 'any profession, trade, employment, vocation or calling, but does not include occupation as an employee': s995-1
 - **What is a business? *Ferguson***
 - Significant commercial purpose or character; Intention to engage in business; Profit making purpose; repetition and regularity; organisation and systematic; size and scale of operations; nature of the activity; whether the activity is better described as a hobby or form of recreation or sporting activity *Ferguson Indicia*
- b. **SECOND: Identify the scope of the business income**
- Amounts derived from carrying on a business are income: *Californian Copper; Scottish Au Mining*
 - There must be sufficient connection to the business activity: *FCT v Spedley; FCT v Merv Brown*
- c. **THIRD: Identify the scope and ordinary proceeds of a business**
- Isolated Transactions

- A mere realisation is a capital receipt: **Scottish AU Mining Co Ltd v FCT**
- Isolated transaction with an intention to profit is income in ordinary concepts: **FCT v Myer**
- Transaction forms a business: **Whitfords Beach**: (how active was the taxpayer; more substantially involved and organized you are will be carrying on business) **Statham**
- **Extraordinary transaction Myer Emporium**:
 - For Myer to apply a transaction that is outside the normal business of the TP, there must be a commercial transaction entered into with the intention to profit, and a profit must be made through the means intended: **Westfield**
 - A lump sum takes on the character of the income stream which it replaces
- **Receipts from illegal activities** are income: **Patridge**
 - It is assessable provided it would have been assessed if the activity was legal: **La Rosa**

3. INCOME FROM PROPERTY IS ORDINARY INCOME

Gains from the use of property have the character of income; Montgomery; McNeil. Income from property – dividends; interest; rent; royalties; annuities

a. Interest

- Payment which becomes due because the creditor has not had his money at the due date: **Riches v Westminster Bank Ltd**
- Interest will generally sit as 6-5 OI
- Interest on Compensation: Pre judgment (capital): **Whitaker**; Post Judgment: s51-57 exemption

b. Dividends

- Distribution of company profits to shareholders: s6-5 OI
- Dividend is assessable and can sit as statutory pursuant to s44 ITAA36

c. Annuities

- A stream of payments that occur at regular intervals for a fixed length of time (or life)
- Full amount of a regular annuity payment is regarded as OI as its regular payments, relied upon and expected: **Egerton v Warburton**

d. Royalties

- Payments for rights over property (e.g. copyright)
- Section 15-20 deems royalties to be assessable as statutory income. There is a contrary intention – meaning where a royalty is OI, it will be assessable as ordinary income
- Royalty is based on usage: **McCauley v FCT** (amount of timber removed was based on usage)
- **Stanton v FCT**: Agreement was not a royalty but capital – because agreement expressed a premeditated amount

COMPENSATION FOR LOST INCOME:

- Compensation for loss of capital

- Whether compensation constitutes assessable income will depend on the nature of the compensation: **C of T (NSW) v Meeks**
- Compensation takes the character of what it replaces **C of T (NSW) v Meeks**
- Payments for the loss or sterilization of capital assets are generally capital in nature: **Glenboig Union Fireclay Co** (i.e. loss of ability to work, loss of reputation: **Sydney Refractive**; loss of assets
- **Mixed Capital and Income:**
 - Courts will treat the whole compensation as non-assessable capital payment if it contains some portion of capital (no matter how small)
 - Generally capital gains (that is profits on the disposal of capital assets) are not ordinary income: **McLaurin v FCT**
- **Sun Newspapers Ltd v FC of T** sets out the test for distinguishing outgoings on revenue as opposed to capital account. Must consider:
 - *The character of the advantage sought*
 - *The manner in which it is to be used*
 - *The means adopted to obtain*

- Compensation for cancellation of agency agreements

- Question of degree – how significant or insignificant it is to the loss of business
- **Collapse in Market:** Generally, compensation for lost income caused by terminating one of a number of business contracts will generally be income in ordinary concepts: **Heavy Minerals Pty Ltd v FCT**
 - (**Heavy:** Payments were OI in the hands of the TP. Operations had been abandoned b/c of collapse in market not as a result of cancellation in contracts – therefore OI)
- Must be a substantial part of business, ceasing to carry on business or disposing of a fixed framework of business: **Allied Minerals Industries**
- Where a trading contract is so fundamental that its cancellation affects the very continuation of the business, and impacts upon the value of the taxpayers business, compensation paid may be capital in nature: **Van Den Berghs Ltd v Clark**

- Mutual Receipts

- Principle of mutuality provides income must come in and therefore be derived from outside sources: **Bohemians Club**
- The mutuality principle operates to prevent amounts that otherwise bear income likeness from becoming income.
- Not essential: **Myer Emporium**