Income from Personal Exertion

- Your assessable income includes income according to ordinary concepts, which is called ordinary income. ITAA 1997, s 6-5(1)
    - This means that a gain that is regarded by courts as being of an income character will be 'ordinary income' and, as such, assessable under s 6-5.
    - The word 'income' is not a term of art, and…must be determined in accordance with ordinary concepts and usages of mankind. *Scott v FCT* (1935)
    - For an amount to be income from the provision of services, there must be a direct connection between payment and the service – the payment must be in consequence of the provision of services. *Hayes v FCT* (1956)
- The two essential prerequisites of a receipt being ordinary income are that it is:
    - Cash or cash convertible. *FCT v Cooke* (1980)
        - Section 21A of ITAA 1936 deems non-cash business benefits as being cash-convertible.
            - S 21A does not deem the non-cash receipt to be income, but rather it deems the benefit to have a cash value so that it satisfies the prerequisite
    - A real gain to the taxpayer. *Hochstrasser v Mayes* [1960]
- Generally the courts have used a two-step approach to determine whether an amount is ordinary income from personal exertion:
    - First, identifying the activity undertaken
    - Secondly, determining whether the receipt is a reward for performing that particular activity
- Establishing that there is a nexus between the amount received and the work performed is an essential element for determining whether the receipt is ordinary income under s 6-5 of ITAA 1997.
    - Once it is shown that there is a nexus between the benefit and the activity performed, it does not matter whether the payment is made before, during or after the completion of the task. *Hochstrasser v Mayes* [1960]
    - It is also irrelevant whether the benefit is provided by the entity for which the task was performed, or by an unrelated third party – it will still be ordinary income. *Kelly v FCT* (1985)
    - It is irrelevant whether the payments are from an ongoing regular employment contract or a one-off receipt contractually required to be paid for the performance of a given task. *Brent v FCT* (1971)
    - Determining whether a receipt is the product of personal exertion may also be explored using a negative approach, by asking whether the receipt arose for some reason other than employment or the provision of a service. *FCT v Harris* (1980)
    - Income is only assessable in the year derived and employment income is normally derived when it is received and not at the time the work is performed.
- Unexpected or voluntary payments received as a reward for service are ordinary income as the benefit is an incident of employment. *Laidler v Perry* [1965]
    - Unexpected or voluntary payments may also be classified as ordinary income based on the nature of the payment, rather than any nexus with employment or services. *FCT v Dixon* (1952)
- A gift given for personal qualities is not regarded as ordinary income and would not normally be assessable to the recipient. *Hayes v FCT* (1956)
    - When distinguishing between a non-assessable personal gift and assessable voluntary payments for service, the courts have given more weight to the nature of the receipt in the hands of the recipient, rather than the motive of the giver. *Scott v FCT*
    - The characteristics of a personal gift established in *Scott v FCT* emphasise the importance of the personal relationship of the parties in distinguishing between receipts that are a product of personal services or a personal gift.
    - Whether a voluntary payment is ordinary income or not will depend on whether it has a sufficient nexus to the service provided.
        - Whether the gift was expected. Expected receipts are more likely to be ordinary income. *Scott v FCT*

        - Whether the gift consists of a lump sum or regular payments. If it consists of regular payments, then it is more likely to be income. *FCT v Blake* (1984)
        - The motive of the donor. If the donor intends the gift to be a reward for services, the gift is more likely to be ordinary income. *Scott v FCT*
        - Whether the recipient has already been remunerated for his or her services. If so, this makes the voluntary payment less likely to be ordinary income. *Scott v FCT*
        - Whether there was a personal relationship between the donor and recipient. The existence of a pre-existing personal relationship will make the voluntary payment less likely to be ordinary income. *Hayes v FCT* (1956)
- Winnings from gambling will be a windfall gain unless the gambler is in the business of gambling. *Babka v FCT* (1989)
    - For prizes to be classified as ordinary income they would have to be earned as a result of a business activity or the degree of personal exertion and skill would have to outweigh the element of chance.
        - It is a question of degree as to whether the level of personal exertion is sufficient to turn a prize into ordinary income. *Kelly v FCT* (1985)
    - The Court relied on six factors to determine whether the gambling activities amounted to a business: *Brajkovich v FCT* (1989)
        - Whether the betting is conducted in a systematic, organised and 'business-like' way
        - The scale of the gambling
        - Whether the betting is related to, or part of, other activities of a business-like character such as breeding horses
        - Whether the bettor appears to engage in his activity principally for profit or principally for pleasure
        - Whether the form of betting chosen is likely to reward skill and judgment or depends purely on chance
        - Whether the gambling activity in question is of a kind which is ordinarily thought of as a hobby or pastime
- Receipts that are not convertible to cash are not of ordinary income. *Payne v FCT* (1996)
    - If the benefit is convertible to money through the sale or via other means, then the question of the benefit's assessability as ordinary income will rest with whether the benefit shows a nexus with personal exertion.
- Payments for changes to entitlements under employment and service contracts may give rise to capital receipts for the giving up of valuable capital rights and therefore not fall into the category of ordinary income. *Bennett v FCT* (1947)
    - This follows the principle that compensation takes the form of what it replaces in that compensation for the loss of capital rights will be a capital receipt.
- Characterising receipts from entering a restrictive covenant as capital or ordinary income will depend on whether the payment relates to the current employment agreement or whether it is separate agreement to give up valuable rights.
    - However, where the restrictive covenant is commonly used as part of the normal employment contract it will be ordinary income as it is generally viewed as a payment for future services. *Higgs v Olivier* [1952]
    - Payments made at the termination of a service agreement that restricts the activities of the taxpayer are seen as capital as they do not arise out of the employment or service contract and do not show a nexus with the earning capacity. *Hepples v FCT* (1991)
    - Capital receipts may also arise out of a restrictive covenant agreed to at the time of entering a contract, and the characterisation of these receipts will again be based on whether the payment is for giving up a valuable right or for services provided. *FCT v Woite* (1982)
        - Where a sign-on fee is a normal part of the practices of attracting sportspeople and employees into a new contract, the payment is less likely to be capital and more likely to be ordinary income as a one-off payment for future services. *Pickford v FCT* (1998)
- Section 15-2(1) of ITAA 1997 states, 'Your assessable income includes the value to you of all allowances, gratuities, compensation, benefits, bonuses and premiums provided to you in

respect of, or for or in relation directly or indirectly to, any employment of or services rendered by you (including any service as a member of the Defence Force).'
    - Section 15-2 does have a contrary intention in s 15-2(3)(d), which means that if a gain is ordinary income, it will not be covered by s 15-2.
    - For these gains to be assessable under s 15-2 there must also be a nexus between the gain and the services.
        - However, case law indicates that the nexus test is easier to satisfy under s 15-2 than it is for ordinary income. *Smith v FCT* (1987)
- The first requirement for a gain to be assessable under s 15-2 is there is an 'allowance, gratuity, compensation, benefit, bonus or premium'.
- The second requirement for a gain to be assessable under s 15-2 is that the allowance, benefit etc. is 'provided to you'.
- The third requirement for a gain to be assessable under s 15-2 is that what has been received by the taxpayer is 'in respect of, or for or in relation directly or indirectly to, any employment of services rendered by the taxpayer'.
    - The Court held that a mandatory compensation payment made by an ex-employer to compensate the taxpayer for loss of earning ability was not assessable under s 15-2. *FCT v Inkster* (1989)
        - The Court held that if the compensation was discretionary as a reward for services than the payment would have fallen under s 15-2.

Fringe Benefits Tax

- The liability to pay this tax is imposed on the employer, not the employee. FBTAA s 66(1)
    - An FBT year is from 1 April to 31 March
- The term 'Fringe Benefit' is defined in s 136(1) of FBTAA.
    - A fringe benefit exists where there is:
        - A benefit
        - Provided during the year of tax
        - By an employer, associate or third party arranger
        - To an employee or an associate
        - In respect of the employment of the employee
- The term 'benefit' is defined in s 136(1) of FBTAA and includes any right, privilege, service or facility provided under an arrangement in relation to the performance of work.
    - Section 6 of the FBTAA confirms this by providing that the specific categories of fringe benefits do not limit generality of the expression 'benefit'.
- The term 'provide' is defined in s 136(1) of FBTAA.
    - In relation to benefits it includes 'allow, confer, give , grant or perform'.
- 'Employer' is defined in s 136(1) of the FBTAA as a person who pays , or is liable to pay, 'salary or wages'.
    - Section 137 ensures that the FBT legislation applies in situations where there is a clear employment relationship but the employee is remunerated with non-cash benefits instead of salary or wages.
    - The definition includes current, former and future employers.
- The definition of 'associate' in s 136(1) refers to s 318 of the ITAA 1936 and s 159 of the FBTAA.
    - Where the employer is a 'natural person', the employer's associates include:
        - Relatives
        - A partner of the employer and their spouse or child
        - A partnership in which the employer is or was a partner
        - Trustees of trusts where the employer or the employer's associates may be a beneficiary
    - 'Relative' is defined in s 995-1 of ITAA 1997 as a person's spouse of that person's parents, grandparent, sibling, uncle, aunt, nephew, niece, lineal descendant or adopted child of that person or that person's spouse.
    - 'Spouse' is defined in s 995-1 to include de facto and same sex relationships.
- An 'employee' is someone who receives salary and wages and includes current, former and future employees. FBTAA s 136(1)
    - A fringe benefit can also arise where the benefit is not provided to an employee directly, but to an associate of an employee.
    - A person will also be deemed to be an 'associate' of the employee where a benefit is provided to the person due to an arrangement between the employer and the employee. FBTAA s 148(2)
    - The benefit provided must relate to a particular employee. *Essenbourne Pty Ltd v FCT*
- The benefit must be provided in respect of the employee's employment to qualify as a fringe benefit.
    - The definition of 'in respect of' in s 136(1) of FBTAA specifies that, to qualify as a fringe benefit must be provided 'by reason of, or by virtue of, or for or in relation directly or indirectly to, that employment'.
    - What is required is a sufficient link for the purposes of the particular legislation. It cannot be said that any causal relationship between the benefit and the employment is a sufficient link so as to result in a taxable transaction. *J & G Knowles & Asscoiates Pty Ltd v FCT* (2000)
        - Their honours proceeded to suggest that, for the benefit to constitute a fringe benefit, there must be a 'sufficient and material relationship' between the employment and the provision of the benefit.
- The definition of 'fringe benefit' in s 136(1) of the FBTAA specifically excludes certain items from being a fringe benefit, including:
    - Salary and wages

        - ‘Salary and wages’ comprise all amounts paid as a reward for services rendered by an employee. *FCT v J Walter Thompson (Australia) Pty Ltd* (1944)
        - The description of the payment is not determinative and it is necessary to look at the substance of the payment to determine its character. *RTA v FCT* (1993)
    - Superannuation contributions;
    - Payments from superannuation funds;
    - Benefits under an employee share scheme; and
    - Payments on termination of employment
- The statutory formula method applies automatically unless an employer elects the cost basis. FBTAA s 10(1)
    - An employer’s election to use the cost basis is automatically disregarded if the statutory formula method results in a lower taxable value. FBTAA s 10(5)
- **Statutory formula method (s 9 of FBTAA):**
    - [0.2 x Base value of the car x (Number of Days during that year of tax on which the car fringe benefits were provided by the provider/Number of days in that year of tax)] – Amount (if any) of the recipient’s payment.
        - The base value of the car will be either its costs (if the car was purchased by the provider) or the leased car value at the earliest time the provider started to hold the car (if the car is leased).
            - The amount is reduced by one-third if the relevant FBT year commences at least four years after the provider first started holding the car. FBTAA s 9(2)(a)
- **Cost basis (s 10 of FBTAA):**
    - Taxable value = [C x (100% - BP)] – R
        - C is the operating cost of the car during the holding period
            - The operating cost of the car consists of any expenses relating to the car incurred by the provider or any other person during the holding period.
            - Examples of such expenses include repairs and maintenance, registration and insurance attributable to the holding period.
            - Where the car is owned by the provider, an amount for deemed depreciation and deemed interest is also included in operating cost.
        - BP is the business use percentage of the car during the holding period
            - The ‘business use percentage’ is the percentage of the business kilometres travelled by the out of the total kilometres travelled by the car during the holding period.
        - R is the amount of the recipient’s payment (if any).
- Having determined the taxable value of each fringe benefit, it is then necessary to determine whether the fringe benefit is a Type 1 fringe benefit or a Type 2 fringe benefit.
    - A Type 1 Fringe benefit exists where the employer is entitled to input tax credits in relation to the provision of a fringe benefit. FBTAA ss 5C(3), 149A
    - A Type 2 fringe benefit is any fringe benefit which is not a Type 1 fringe benefit. FBTAA s 5C(4)
- The next step is to calculate the ‘fringe benefits taxable amount’ as proscribed by s 5B of the FBTAA.
    - **Total Taxable value of all Type 1 Fringe benefits x 2.1463**
    - **Total Taxable value of all Type 2 Fringe benefits x 1.9608**
- The final step is to determine the employer’s fringe benefits tax liability, which is calculated as:
- [(Type 1 Fringe benefits taxable amount) + (Type 2 Fringe benefits taxable amount)] x FBT Rate (49%).