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W1 Australian Tax System

Common law system, income tax, GST, interaction between



OECD: Tax Revenue Statistics (% of total tax revenue)

Taxes	Aus	NZ	Jap	Ger	Fra	UK	US	OECD average
Personal income tax	39	38	19	26	19	28	39	25
Corporate income tax	18	14	13	5	6	8	9	9
Social security	-	-	41	38	37	19	23	24
GST/VAT	28	38	18	28	24	33	17	33

Most of personal income tax (PIT) depend on personal contribution, individual’s work
 Both income (personal income, corporate income) tax are income tax, but different rates, AUS is levying heavily on personal and corporation income tax, they are self-assessment, AUS GST is low

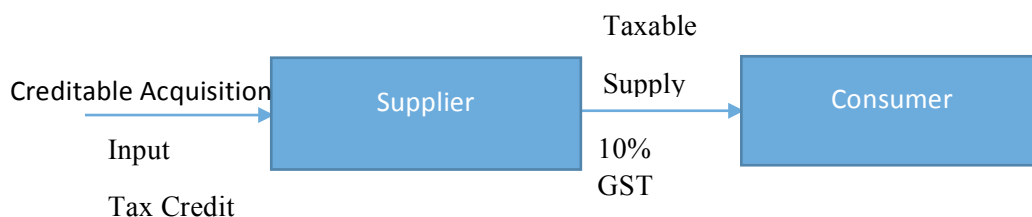
GST—Overview

Common sense, objective

Registered for GST

Buy cup marital, paid sb. Else—in consumer situation; broad test—turnover > \$75,000

\$11 paid—paid out \$1 GST to supplier, collected \$2 GST—net off, send excess \$1 or some case claim



It is the **tax credit**, not GST

Manufacturer sell cup \$20, charge \$22, collect \$2 GST, **not their income**, \$2 have to send to tax office

- Turnover tax: cf. income tax
 - Input tax credit for business
 - (GST based on turnover > \$75K)
- Taxpayer:
 - **Supplier** of goods and services
 - (Ultimate, **burned by the end consumer**, chain of people (supplier), stop at the person **who not registered** on GST)
- Taxable transactions:
 - **Consumptions** of goods and services in Australia
 - (Based on taxable supplies)
- Tax rate:
 - 10% on the value of goods and services
 - =One-eleventh of the price of the supply
 - (Exempts)
- Three types of 'supplies':
 - Taxable supplies (charge GST)
 - GST-free supplies (**no GST**) (vegetable, education, religion, but if paid for making supplies, **can claim input credit**)
 - Input taxed supplies (**no GST**) (**Cannot claim input tax credit**, financial supplies, residential rent)
- GST-free supply: **can claim** input tax credit
 - Essential living expenses: e.g. food, health, education and child care
 - For "**competitiveness**": exports (claim GST refund)
 - Charitable activities: e.g. religious services
- Input taxed supply: **cannot claim** input tax credit
 - Examples: financial supplies, residential rent
- International implications:
 - Import: importers of goods subject to GST in general
 - Exemptions: e.g. customs value below \$1,000
 - Export: **0% rate** with **refund of input** tax credit

Type of Supply:	Taxable supplies (Div 9)	GST-free supplies (Div 38)	Input taxed supplies (Div 40)
	Charge GST	Not charge GST	Not charge GST
Can Input Tax Credit be claimed?	YES	YES	NO (exception for certain financial supplies)
Examples	Law firm providing legal advice (criteria)	Food, health, education	Financial supplies, residential rent, precious metals (fee exceptions: acquirer financial supplies may claim some part)

GST—Interactions with Income Tax

- Income:

- **Exclude** GST component: s. 17-5 ITAA 1997 (**GST is not income**)
- Deduction:
 - If entitled to **input tax credits**: **exclude** GST component: s. 27-5 ITAA 1997 (net amount, what pay tax on) (cost not included)
 - Otherwise: **include** GST
 - (not registered, double side, not bear GST but not claimable credit; cost: 11, income: 22, if charge 22)

GST—International Comparison

Country	Year of introduction	General rate when introduced	General rate - 2015
Australia	2000	10%	10%
France	1968	20%	20%
Germany	1968	11%	19%
Japan	1989	3%	8%
New Zealand	1986	12.5%	15%
Sweden	1969	17.65%	25%
UK	1973	8%	20%
US	n/a	n/a	n/a

Listed country, tax regimes comparable to AUS

Income Tax Rates: Residential Individuals

Tax Rate (2016-2017)	Taxable Income (brackets)
0%	0— 18,200
19%	18,201—37,000
32.5%	37,100—80,000
37%	80,001—180,000
45%*	> 180,000

Different to non-resident

*Plus **2%** “Temporary Budget Repair Levy” for 2014-2015 to 2016-2017, resulting in a **top marginal tax rate** of **49%** (including Medicare levy)

Progressive tax rate, tax only on the difference between levels

Rate different on different income

Non-Resident tax rate start from 32.5%--49%

Top Marginal Rates for Employees (2005) (source: OECD) (where the top marginal rate kits in)

Country	Top marginal rate	Threshold
Australia	48.5%	1.4
Canada	46.4%	2.9
Germany	44.3%	1.4
Japan	47.9%	4.5
New Zealand	39%	1.5
UK	41%	1.3
US	42.7%	10.6

Individual Income Tax Rates: Issues

- 1950s: 19* average earnings → top marginal rate (before the top MRA kits in)
- 2005: only requires 1.4 times (wages go up—more people are closer and closer getting to TMR)

- **Bracket creep**
- Now?
 - About 2 times
 - Long-term solution?
 - (The higher earn, the higher tax but still get other brackets)
 - **(Balance the problem, matters of balancing the brackets, and rates charged)**
 - (Keep threshold, which bracket to increase? If 1st—expensive to government—all people exempt from that part)

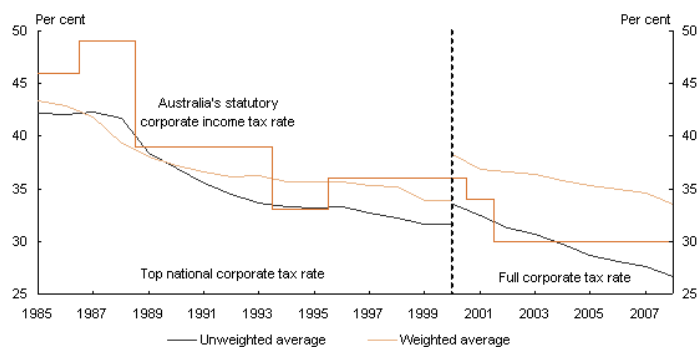
Income Tax Rates

- Medicare levy: 2% for resident individuals and certain trustees
 - Increase from 1.5% since 1 July 2014 (to fund the national disability insurance scheme)
- Temporary Budget Repair Levy: 2%
 - For resident individuals with **taxable income >180,000**; applicable for 2014-15, 2015-16 and 2016-17 income years (to bring income to surplus)
- Company: 30%
 - Exception: 28.5% for companies that are small business entities (reduced tax rate applicable from 1 July 2015)
- Trust: 47% or **beneficiary's marginal tax rate** (not trustee)
 - Except trusts taxed as companies
- Partnership: flow-through treatment (tax partner of partnership (all income flow to partner)
 - Except limited partnership
- Superannuation funds: 15% (earnings)

Corporate Income Tax Rates (source: IBFD)

<i>Country</i>	<i>Corporate income tax rate</i>
Australia	30%
Canada	26.5%
Germany	15.8%
Japan	25.5%
NZ	28%
UK	20%
US	35%

30% is not effective tax rate, depend on industries, tax paid/ income earned. Have various exemptions → ≠ 30% rate



Company Tax Rates of OECD Countries

Flat rate; declining average
 enjoy 30%--OK as long as it is the true company—people high income, set up company, divide income to company set up, it is within spirit of legislation
 How to avoid decrease to bottom if rate is low—competitive in international

2 points: what rates attract investment,

balance of maximise tax income (also depend on other countries)

Tax Arbitrage—Tax Rates

- Between individual and corporate tax rates
 - Anti-avoidance rules: e.g. (keep right amount of tax received)
 - Personal services income regime
 - Constructive dividends of private companies
- Between countries: (cross jurisdiction)
 - Tax havens
 - Low tax countries: e.g. Ireland, Singapore (exempt multinational enterprises, **no tax payable**, multinational corporation set up tax avoidance. Trade-off)

(Tax change people's **investment decision** or **behaviour**—company tax not have brackets; AUS: person earn 7000, people will not set up company)

(Company is a fiction, assets protection of debts and shareholding, shareholder will be taxed for the dividend (dividend company already taxed), if it is loan, not dividend—0 interest, 0 rate (distribute profit))

Criteria for a good tax system

- Criteria
- Priority
- (How to test, balance parity/ between criteria)

Simplicity

- Certainty
- Low compliance cost
- Quiz: % of individual tax payers using tax agents? (today lower—real push to decrease complicity)
(1st criteria) (AUS complex system, push to simplify)
(Why is it sometimes bad? Costly to taxpayer and ATO (small operation)—if simpler, cost less—encourage people to pay—increase tax revenue, decrease tax avoidance, increase comply)
(Bad: loopholes some given up, situation will be **unfair**; change—people will **change their behaviour/investment decision**; trade-off)
(People can get it right, cost benefit trade-off, \$ increase in infrastructure, know to pay and how much to pay, decrease cost of ATO collection)

How complex? (Source: “Paying Taxes 2012” by World Bank & PwC)

A “Fair” tax system

- “**Ability to pay**” principle:
- “**Horizontal**” equity: persons in the **same** situation → tax **equally**
- “**Vertical**” equity: persons in **different** situations → tax **differently**
(Not fair, not pay; increase brackets, increase progressive tax rate; the higher earn, the higher pay; people can afford higher tax—charge higher)

Issues of “ability to pay”

- Difficult to define
 - Even harder to measure

- “Income” as proxy for “ability to pay”
 - What is “income”
(Tax ability to pay) (When pay more, the higher ability to pay tax)
- Taxpaying unit
 - Individual, married couple, family, closely held entities
(Tax how much every person contribute to society)
(Core tax return filled in as individual losses)
- Timing issue
 - Fluctuation of income vs annual return
(Cyclical income, income is not always a great proxy)

Issues of “vertical” equity

- How much more to pay? (Brackets capture, the higher ability)
- Equity based on **amount** or **percentage**? (Increase in house value—how to measure; problem (If not assessable e.g. increase in market value)

Vertical equity: case study (question: how progressive rates are) (decreased ability)

Mr	Income	Extreme equity	Progressive rates	Flat rate (20%)	Fixed amount
A	\$1,000	\$950	\$470	\$200	\$20
B	\$100	\$50	\$20	\$20	\$20

Efficiency

- Definition: tax system should **be neutral**, **not affecting taxpayer’s behaviour**
- Any deviation from **neutrality**: should be limited in scope and time (Asprey Report) (tax implications)
(Easy to collect, not estop **people investment decision**)

Efficiency: business structure

Business structure	Tax rate for entity	Tax rate for owner/beneficiary
Sole trader	N/A (tax individual not tax company)	0%-49%
Company	30% (tax company and shareholder , up to progressive rate)	
Trust	0%-49% (trustee or beneficiaries behind)	

(What is the structure?)

International Competitiveness: Acquired Goodwill

- Australia: no amortisation (not competitive)
- Canada: 75% cost amortisation; up to 7% p.a. (1971)
- US: 15-year straight line amortisation (1993)
- UK: follow accounting treatment; minimum 4% p.a. (2002)
(What is happening around the world, every aspect; How to be competitive to **other jurisdiction**)
- Competitions between countries (cross trade) (increase central important)
 - Tax rates: e.g. China’s 25% enterprise income tax rate
 - Tax concessions: e.g. UK’s patent box regime @10%
 - Loopholes : e.g. US’s check-the-box regime
- Facilitate base erosion profit shifting (“**BEPS**”)

- E.g. Apple's iTax structure (<http://ssrn.com/abstract=2411297>)
- OECD's BEPS Project (sign to prevent double tax) (<http://www.oecd.org/ctp/beps.htm>)
- Country by Country Reporting from 1 Jan 2016 (multinational corporation >1 billion more reports. What subsidiaries are, tax administration can **share information**—where profits made, where profits booked; different rules, **arbitrage and double non-taxation**; globally—**income should be taxed once**; should not be **double tax or double non-tax**; big focus on double tax before, now—double non-tax) (<https://www.ato.gov.au/law/view/pdf/cgl/lcg2015-003.pdf>)

(Double tax agreement—between AUS and other country—who give up tax to avoid double tax)

W2 Residence and Source

Revision and Feedback

- The three sources of Australian taxation law are (1) legislation (2) case law and (3) ATO rulings (commissions' opinion)
- Individuals are subject to marginal/progressive tax rates while companies are subject to a **flat rate** of 30%
- The top marginal tax rates if a resident individual (including Medicare levy) is 47%
- The tax free threshold for a resident individual is \$0-18,200
- The 3 traditional criteria to judge a tax system are (1) Simplicity, (2) Fairness (equity) and (3) Efficiency. (Trade-off)
- 70% of individual taxpayers in Australia use tax agents
- **Fairness** as a tax policy objective is premised on the **ability to pay** principle who has two dimensions (1) **horizontal** equity and (2) **vertical** equity.
- The **efficiency (or neutrality)** policy objective means that the tax law should **not change investment decision (because of law)**.
- Another policy objective that is increasingly important in recent years is **international competitiveness**. (Countries want to have competitive advantage, to attract investment, may end up **tax avoidance** (permitted in the law), **loopholes**)
- Medical levy is 2% of **taxable income** (ordinary income → assessable income)
- The rate of GST is 10%
- The 3 types of GST supplies are **input taxed**, **GST-free** and **taxable**.

Introduction to ITAA

- Standard for what—Income Tax Assessment Act
- Tax Law Improvement Project (Dec 1993 to late 1998)
 - ITAA 1936 & ITAA 1997
 - Same Law? (1936—tax improvement rewrite half, rewritten one in 1997 Act, but a number remain in 1936, in rewrite no intention to change law, just to plain English, not overlap, operate separate) (cite the correct section e.g. 26(e))
- 1-3(1) This Act contains provisions of the *Income Tax Assessment Act 1936* in a **rewritten form**.
- 1-3(2) If:
 - (a) That Act expressed an idea in a particular form of word; and
 - (b) This Act appears to have expressed the **same idea** in a **different form of words** in order to use a **clearer or simpler style**;
- The ideas are not to be taken to be different just because different forms of words were used—**overcomes statutory interpretation rules** (say the same thing using same words)

Definition Sections

- Defined terms “*”: **s. 2-10(2) & 2-15 ITAA 1997** (in the dictionary)
- s. 995-1 ITAA 1997; Applicable to ITAA 1936?: **s. 995-1(2)(a)** (also dictionary in 1936)
- s. 6 ITAA 1936; Applicable to ITAA 1997?: **s. 6(1AA)** (dictionary)

Numbering System—order

- ITAA 1936
 - s. 6(1), s. 6(1A), s. 6(1AA)
 - s. 6, s. 6A, s. 6AA, s. 6AB
- ITAA: 1997: logical
- Numbering system—Complex
 - E.g. s. 160AQDAA ITAA 1936
- ITAA 1997 tries to avoid the problem by:
 - Format: XX-XX (divisions separate by -)
 - Gaps: already out of space (e.g. s. 165-115GA, GB, GC, etc. next section, spaces to put in next section)

ITAA 1997—Structure

- **Operative** vs **non-operative sections**: **s. 2-35 ITAA 1997**
 - **Guides**: **s. 2-40** (overview of how operate, not strictly a part of law)
 - Status: s. 950-150 (none is operative, do not cite in anywhere)
 - **Other material** (e.g. notes and examples): s. 2-45

Charging section—s. 4-10(1) ITAA 1997

- Tax Equation: $\text{Income Tax} = (\text{Taxable income} * \text{Rates}) - \text{Tax Offsets}$ (progressive or flat rate)
- Taxable income: **s. 4-15** $\text{TI} = \text{Assessable Income} - \text{Deductions}$ (how much assessable income is payable)
- Applicable tax rate (tax law concepts, **progressive or flat**)
- Tax offsets: list in s. 13-1
 - e.g. **franking credits on dividends** (credit for tax owed, credit from tax company paid), foreign income tax (overseas, not double tax)
 - From 2015-16 income year: small business income tax offset
 - 5% discount on tax payable by individuals carrying on (directly or indirectly through partnerships and trusts) small businesses, delivered as a tax offset
 - Tax offset capped at \$1,000 per individual per income year
- Tax administration: **PAYG system** (individual→employer, during year pay as you go—end of year reconcile)

Residence and Source Principles

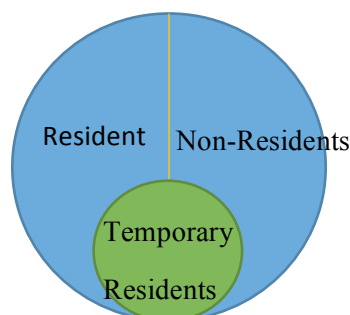
Overview

- **Ability to pay principle**
 - Tax on worldwide income
 - **Residence principle** (basis of law, who residency country is)
 - Closest economic and social ties→residence country
- Residence country: **not exclusive right** to tax (based on ability to pay)
 - **Source country**: also has right to tax → **source principle**
- Double taxation issue:

- Share tax revenue between countries
(Source country also have right to tax, agreements allocate tax and rights ORCD model, similar but not identical, if am resident, pay tax wherever income from)
- Aim: **total tax = residence country tax**
 - Consistent with “**ability to pay**” principle
(Ideal amount, probability source country tax)

Assessable Income

- A.I. = O.I. + S.I. (Assessable income = Ordinary Income + Statutory Income)
- O.I.: s. 6-5 (same for S.O.: s. 6-10) (ordinary income)
 - 2 important concepts: **Residence** and **source** (tax based on where residency/sourced)
- Residence: resident vs non-resident (different treatment)
- Since 2006, another concept: “**temporary resident**” (treat as non-residence)
- 6-5(1) Your **assessable income** includes income according to **ordinary concepts**, which is called **ordinary income**. (Assessing provision)
- 6-5(2) If you are an **Australian resident**, your assessable income includes the *ordinary income you *derived directly or indirectly from **all sources**, whether in or out of Australia, during the income year. (Ability to pay, if is AUS resident, all income from all over the world)
- 6-5(3) if you are a **foreign resident**, your assessable income includes:
 - (a) The *ordinary income you *derived directly or indirectly from **all *Australia sources** during the income year; and (**AUS sourced income**)
 - (b) Other *ordinary income that a provision includes in your assessable income for the income year on some basis other than having an *Australian source.



Temporary residents: overlay, extra concessions, both can be considered remain being

Individual Tax Rates 2015-2016

Bracket (\$)	Resident	Non-resident
0-18,200	0%	32.5%
18,201-37,000	19%	
37,001-80,000	32.5%	
80,001-180,000	37%	
180,000+	45% (plus 2% Temporary Budget Repair Levy)	

Note: **non-residents not liable** to Medicare Levy of 2%

Residence

- “Residence”: typical policy
 - Exceptions
 - The US
 - HK, Singapore & Australia (before 1930) (source based) (double tax rules)

- Companies: source taxation increasingly common
 - Individuals: “temporary resident”
- 2 major **overrides** of R&S principles:
 - **CGT**; and (capital gain (asset) tax non-resident not subject to asset)
 - **Withholding** tax on passive income (income tax withheld from employees’ wage and paid directly to the government by the employer) (A tax levied on income (interest and dividends) from securities owned by a non-resident)

Australian Resident

- Definition: *s. 995-1 ITAA 1997*
 - Australian **resident** means a **person** who is a resident of Australia for the purposes of the Income Tax Assessment ACT 1936
 - “Person” definition in s. 995-1
 - **Person includes a company** (person → individual include company)
- “Resident of Australia”: *s. 6(1) ITAA 1936*
- *Resident or resident of Australia* means: (**4 tests**)
 - (a) a person, other than a company, **who resides** in Australia and includes a person (1st test ordinary meaning test)
 - i. whose **domicile** is in Australia, unless...**permanent place of abode** is outside Australia; (2nd domicile test)
 - ii. who has actually been in Australia, continuously or intermittently, during more than **one-half** of the **year of income**, unless...**usual place of abode** is outside Australia and that he does not intend to take up residence in Australia; or (3rd 183-day test, reside test)
 - iii. who is ...a member of the [Commonwealth] **superannuation scheme**...; and (4th superannuation, statutory extension)
 - (b) a company which is ...

Resident of Australia—Individuals

- **4 tests** (different from migration law):
 - Primary test: “**reside**” (ordinary)
 - Supplementary tests: (statutory extension)
 - “**Domicile**” & (unless) “**permanent** place of abode”
 - “**Half year**” test & (unless) “**usual** place of abode”
 - “**Superannuation** scheme” test

“Reside”

- **Primary source of tax law** (legislation)
 - Meaning of “**reside**”? (General meaning, physical)
 - What factors to consider? (Family)
- Can be **part year** resident (flexible test, daily basis, test again when intent to move)

“Reside”—case law

- **Second source of tax law** (case law)
 - Dictionary: “to **dwell permanently** or for a **considerable time**...”
 - A question of **fact** and **degree** (consider all circumstances)
 - Examples: (closely related get different outcome) (simplicity—not certain)
 - **Levene** (UK resident not have settled place in other places claim as non-resident, less clear reside in 2 places still have ties with UK, until settlement somewhere else)

- **Lysaght** (Director who want to retire in UK, move to Ireland then appointed as advisory director, back a week for month, still resident in UK)

“Reside”—Factors to consider (para. 20)

- Home (where)
 - Family, business and social ties (friends—careful type of **personal behaviour**)
 - Physical presence
 - Residency history
 - Frequency & regularity of movement (routine: compare to backpacker or more settled)
 - Purpose of presence (because of business, or want to wonder around or settle)
 - Nationality (minor importance)
- (Which one more **weight** depend on circumstance of person)

TR 98/17

- **Migrant:**
 - **Come** to Australia permanently→resident (6 mth, “dwell”, “considerable amount of time”)
- **Rule of thumb** (though not decisive: para. 18):
 - Live **continuously** here > **6 months: para. 22 and**
 - **Behaviour consistent** with residency:
 - Factors: **para. 20** (evidence behaviour)
 - Prima facie resident

Example 6: agree?

90. Maria Congiunto is a single Italian woman who has a number of relatives living in North Queensland. She is employed as an engineer in Milan. Through her family in Australia, Maria has accumulated a portfolio of Australian investments. She usually visits Australia every second year to see her relatives and to check on her investments.

91. As a result of a serious illness, Maria has been advised by her doctor to give up work until she fully regains her health. She asks a friend to live in her home in Milan while she spends nine months with her niece in North Queensland recuperating. In Australia, she lives at a particular place and has regular appointments at the hospital, she opens an Australian bank account and as soon as she is able, she leases a car and joins the local Italian club. As planned, she returns to work in Italy after nine months.

Decision: **resident** (M is a single, 1. Give up job for 9mths, employment ties given up; 2. Relatives AUS family 3. Settled, not like back up, **routine** (appoint in hospital) car club—yes)

(Paragraph 43: Where the **day to day behaviour** of individuals, considered over time, is relatively **similar to their behaviour before** entering Australia, they are likely to be regarded as residing here. Even when their behaviour over time is different from their behaviour before entering Australia, they are likely to be **regarded as residing here**, when the facts of their presence **indicate a routine establishing they are living** in Australia.)

Example 9: consistent?

101. Janine Edgerton is a British national who has longed to spend twelve months 'down under'. After saving for years, she takes twelve months leave from her work and departs for Australia on her twenty-fourth birthday. Although she travels with considerable savings, her intention is to spend at least part of her time working. She has obtained a restricted working visa enabling her to work for no more than three months with one employer.

102. Through a contact in Australia she is assured of work in Perth for the first three months. After that period, she decides to travel to the east coast via Adelaide. She spends a month in Adelaide where she works for two weeks and continues her journey to Melbourne.

103. Once there, she meets some friends from back home. After working for a further three months, she

decides to spend the balance of her time in Melbourne and uses her savings for living expenses. To keep costs down, she leases a house with two other friends. At the end of her twelve months in Australia, she returns to the United Kingdom.

Decision: non-resident (main difference: moving around; employment time relative transitory)

((a) Intention or purpose of presence Paragraph 47. The **individual's intention, purpose or reason** for being in Australia assists in determining whether an individual resides here: Gregory. While individuals may have multiple reasons, there is usually a **main purpose** to their presence.)

Issues:

- **Temporary resident?**
- Treaty implication?

TR 98/17 – Expatriate

- May be resident (**para. 44 & 45**)
 - Tough rules (can have more than 1 residency, and rules in different country different)
 - Ralph Report suggested to exempt expat's foreign income for 4 years
 - Amendment effective 1/7/2006:
 - "temporary resident"

"Reside"—ATO ruling

- **Third source of tax law**
 - **TR 98/17**: Residency status of individuals **entering** Australia (tax ruling, coming in AUS)
<http://law.ato.gov.au/pdf/pbr/tr1998-017.pdf>

Temporary Resident

- New concept based on migration law:
You are *temporary resident* if:
 - (a) you hold a temporary visa granted under the *Migration Act 1958*; and
 - (b) you are not an Australian resident within the meaning of the *Social Security Act 1991*; and
 - (c) your *spouse is not an Australian resident within the meaning of the *Social Security Act 1991*
- cf. concepts of "residents" & non-residents"
- Both "residents" and "non-residents" can be "temporary residents"
(1) residency (2) rates (3) temporary residency)
- Effect: **exemptions**: *Subdivision 768-R ITAA 1997*
 - Foreign source income (except employment income)
 - CGT: Taxed like non-residents (except certain gains re employee share schemes)
(investment assets, only AUS investments, like non-resident)
 - Withholding tax obligations on interest

TR 98/17—student

Para. 48 & 50: agree? (education purpose) (intention to reside but not supplement but not supplement, travel by employ temporary, depend on circumstance—transitory)

(a) **intention** or purpose of presence

48. A settled purpose, such as employment or education, may support an intention to reside in Australia. However, the intention must be more than merely being a traveller or visitor who may supplement their savings by obtaining casual employment.

50. However, individuals who enter Australia to take up prearranged employment opportunities or

courses of study may be residing here if their stay is consistent with living in Australia. *Miesegeaes v. Commissioners of Inland Revenue* (1957) 37 TC 493 concerned an individual who was in the United Kingdom for educational purposes. It concluded that residence in the United Kingdom was not only a part of, but the central and essential feature during that phase of the appellant's life.

Example 2: what if leases a flat and family comes over and live together?

73. Michael Desmond is a South African diamond corporation executive. He takes the opportunity to participate in an intensive eight month advanced management development program at an Australian university.

74. Michael's wife and children do not accompany him to Australia and while here he stays in basic accommodation on campus. He spends his time studying or writing reports for his company. He is in Australia solely to do the course and at the end of eight months he returns home.

Decision: **non-resident** (first intention non-resident, do research, not reside, family, nothing do to integrate in AUS, he is not having social life in AUS, intention not to be connected with AUS)

Example 10: contradict example 2?

105. Dipak Neviott is a student from India who comes to Australia to study for a four year bachelor degree in civil engineering. Dipak lives in rental accommodation near the university with fellow students and works part-time at the university social club as a barman. After six months, he has to withdraw from his studies and return to India because his father is ill.

Decision: resident (get job, social links (not assume fact, be clear: if XX case look at that) more integrated in AUS, more likely reside in AUS.

“Domicile” & “Permanent Place of Abode”

- “Domicile”: the place where a person is deemed by law to have his/her **permanent home** (nationality—consider self deem to have home by law)
 - *Domicile of origin* = father’s domicile at (your) birth (domicile of origin unless choice)
 - *Domicile of choice* = require both act and intention to take up a new jurisdiction as permanent home (intentionally and consider)
- “Domicile” vs “residence”: distinct concepts in legal nature and purpose:
 - X can have two residences, **but only one domicile**
 - Equally, X may have no residence, **but must have a domicile** (always get 1 domicile)

Permanent Place of Abode—*Applegate*

- Fact:
 - Employee posted overseas indefinitely
 - Employee expected to return to Australia
 - Terminated his lease of flat in Australia
 - Family accompanied him
- Decision: (not re-announce domicile so still domicile in AUS; not want to break ties, but PPA outside AUS so not resident)(intention: stay in other country)
- Held:
 - “**Permanent**” → **does not require to be “forever”** (otherwise, same as “domicile”)
 - **Permanent place of abode outside Australia, though domicile** still in Australia (not resident)

Permanent Place of Abode—IT 2650 <http://law.ato.gov.au/pdf/pbr/it2650.pdf>

- Rule of thumb (para. 25): (old form of ruling)

- **>2 years abroad** → permanent place of abode **outside Australia** (unlikely to be resident)
- Not conclusive

Factor (a) - length of overseas stay

25. Clearly, the longer an individual's stay in any one particular place, the more permanent in nature and quality of use is likely to be the stay in that place of abode. An individual's intention regarding the duration of the overseas stay and the length of the actual stay are only relevant factors. Where a **taxpayer leaves Australia** for an unspecified or a substantial period and establishes a home in another country, that home will represent a permanent place of abode of the taxpayer outside Australia, subject to a consideration of the other factors listed in paragraph 23 above. **As a broad rule of thumb, a period of about 2 years or more would generally be regarded by this Office as a substantial period for the purposes of a taxpayer's stay in another country.** It must be stressed, however, that the duration of the taxpayer's actual or intended stay out of Australia **is not, of itself, conclusive** and needs to be considered with all of the factors in paragraph 23 above.

Half Year Test

- May need to count **HOURS** in marginal cases: **Wilkie v IRC (1952) 32 TC 495** (183 day unless)
- "Usual": **less stringent than "permanent"** (strike test)
- **Resident for whole year*******
- Work through one by one, if not satisfy all 4, not resident

Source

- No general rule in tax law
 - Specific provision for limited number of items
 - e.g. natural resource income: s. 6CA ITAA 1936
Income derived by non-residents, which is calculated based on the value of quantity of **"natural resources** produced, recovered or produced and recovered, in Australia" → **deemed Australia source.**
- Case law:
 - "a practical, hard matter of fact": **Nathan v FCT (1918) 25 CLR 183**

Some types of income:

- Income from real property
- Personal exertion income
- Business income
- Dividends
- Interest
- (Different rules around cash)

Source—Case Law

Income from real property

- Source: **location of property** (**rental income**, source is property)

Source of Personal Service Income

- **CT (NSW) v Cam & Sons Ltd (1936) 36 SR (NSW) 544**
 - Fact:
 - Men employed to work on trawlers (boats)
 - Trawlers travelled to various locations

- Source:
 - **Location of services performed** (time in AUS—income from that time was AUS sourced)
 - Apportioned income based on working time spent in different locations
- **FCT v French** (1957) 98 CLR 398; 7 AITE 76
 - Source:
 - Deciding factor of a wage was the **place of performance of services** (to carry on project)
 - (was sourced in AUS, source: services are performed)
 - True in general as a fact, but **not a valid legal proposition** (but just a question of fact)
- **FCT v Mitchum** (1965) 113 CLR 401; 9 AITR 559
 - Fact:
 - Film actor resident in the US
 - He entered into a performance contract with a Swiss company for a salary
 - His service was lent by the Swiss company to another company for a fee
 - He worked in Australia for about 11 weeks
 - Held: **no source** in Australia (it is about **who** is doing the work)
 - Reasons:
 - **Place** of performance: **not the only relevant factor**
 - Activities: business nature rather than employment
 - **Place of contract**: dominant factor
 - (All signed/salary paid abroad, personalised service, specific to Mitchum, important is not where is being sourced, but **who is performing**)
- **FCT v Efstathakis** (1979) 9 ATR 867
 - The **greater the skill** the **less significant is the place** of performance
 - (argue: contract signed overseas not for him specifically, not equal to Mitchum case, more important is where carry out, not who do, where is it is more important)

Source of Business Income

- **Cliffs International Inc v FCT** (1985) 16 ATR 601
 - **Negotiations** took place overseas (parent company in US)
 - The information used in the negotiations came from overseas
 - **Negotiations were concluded overseas** and the execution in Australia was merely a **formality**
 - (Where negotiation taking place. Determine source: **where complete contract**)

Withholding Tax on Interest, Dividends and Royalties

- **Overrides** the source rules
- (**passive income** (real property), interest/dividend—not require to have interaction/present in AUS)
- WT applies to a **dividend** paid by an **Australian resident company** to a **non-resident shareholder**: **s. 128B(1) ITAA 1936**
- Income upon which WT is payable is **not assessable income and is not exempt income**: **s. 128D ITAA 1936** (not filled tax credit form. When bank pays withhold certain amount and pay rest to them, replace interest income—non-assessable)

(The WTI is a tax charged on (interest) paid by any person to or for the benefit of a **foreign person** (which includes individuals, companies, etc.) from a source within Australia. **The foreign person is responsible for the tax**, but it must be **withheld by the person making the interest** payment to or

for the benefit of the foreign person.) (Under the Pay as you go (PAYG) withholding rules, you have an **obligation to collect tax from payments** you make to employees and some businesses so they can meet their end-of-year tax liabilities.)

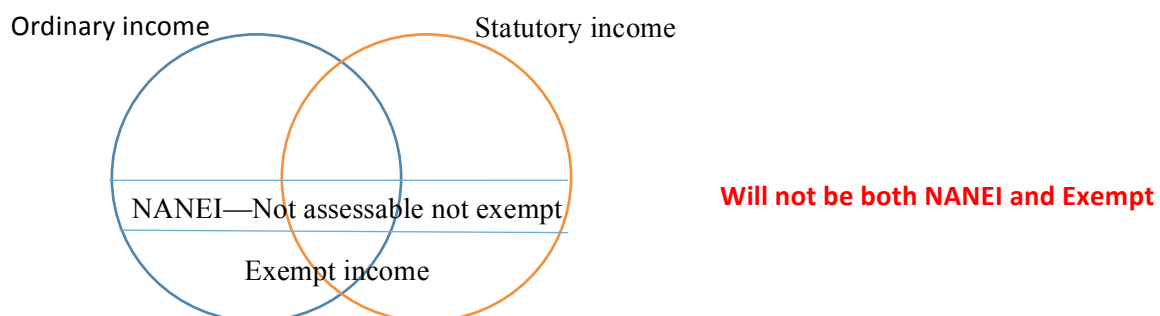
Concepts of Income—Part 1

Revision + Feedback

- Australia’s income tax system adopts the **source** and **residence** principles, instead of the territorial concept.
- An individual is an Australian resident if he/she satisfies one of the 4 tests: (1) **ordinary concept** test. (2) **domicile** test; (3) **183-day** test; and (4) **superannuation**.
- An individual is a resident of Australia if his **Domicile** is in Australia, unless his **permanent place of abode** is outside Australia.
- An individual is a resident of Australia if he is physically present in Australia for more than **183-days** of **an income year**, unless his **usual place of abode** is outside Australia and he is **not intend to take a residency** in AUS.
- ATO’s rules of thumb are more than **6 months** for the **reside test**, and more than **2 years** for the **permanent place of abode test**, but the rules are **non-conclusive**.
- A temporary resident enters Australia with a temporary residency visa.
- The source of income from **personal services** is the location of **service of performance unless special services** while that of income from **real property** is **location of real estate**.
- The two major exceptions to the **residence** and **source principles** are **CGT** and **Withholding tax**.
- Taxable income = **Assessable income – Deduction**

What is “Income”?

- Assessable income = **Ordinary income + Statutory income** (whatever written in law)
- Except:
 - **Exempt** income (not include)
 - **Non-assessable non-exempt income**: s. 6-5(1), 6-10(2), 6-15(2)&(3) (one **offset loss**, one not, not pay tax, not included in AI)



Exempt income

- Definition: **s. 6-20 ITAA 1997**
 - An amount of *ordinary income or *statutory income is **exempt income** if it is made exempt from income tax by a provision of this Act... (Content list, Act literary say exempt sell specifically)
 - List of exempt income: **Subdivision 11-A ITAA 1997**

- Examples: Charitable institutions; specific education and training income
 - **Divisions 50-54** (not limited to 50-54, it is throughout of Act)
- **Not truly “exempt” (offset tax losses)** (exemption income offset)
 - **Affect tax losses:** s. 36-10 ITAA 1997
 - (AI < deduction, negative position → tax loss → carry forward → become a part of deduction)
 - NANEI—**NOT** affect TL

	Company A	Company B
Year 1		
A.I.	\$100	\$100 TL
Deductions	\$(120) (tax losses—20) 20	\$(120) 20
Net E.I. (exempt income)	\$30	\$0 (no EI)
Year 2 A: 10 exempt income—not use tax loss as deduction in year 2, E.I. offsetted		
A.I.	\$180	\$180
Deductions	\$(110)	\$(110)
Net result	\$70	\$50 (-20 carried forward , tax loss in year 1—get deduction of 20)

NANEI

- Definition: **s. 6-23 ITAA 1997**
 - An amount of *ordinary income or *statutory income is **non-assessable non-exempt income** if a provision of this Act...states that it is not assessable income and is not *exempt income
 - Examples: **Subdivision 11-B ITAA 1997**
 - **GST payable** on taxable supply (is not part of income, not limited to that)
 - **Dividend/interest/royalty subject to withholding tax**
 - Division 59 ITAA 1997: particular amounts of NANEI
- Relationship with exempt income: **s. 6-20(4) ITAA 1997:**
 - **If NANEI, then not EI**
- **Not affect tax loss:** genuine “exempt” income (not affect losses)

Statutory Income

- Definition: **s. 6-10(2) ITAA 1997**
 - Amounts that are not *ordinary income, but are included in your assessable income by provisions about assessable income, are called *statutory income* (just what the ACT say it is)
- List of SI: **s. 10-5 ITAA 1997 (operative section)**, refer to the actual section)
 - E.g. capital gains (cite referred section)
- Particular items of SI: **Division 15 ITAA 1997**

Ordinary Income

- Definition: **s. 6-5(1) ITAA 1997**
 - Your **assessable income** includes **income according to ordinary concepts**, which is called **ordinary income**
- Australian courts: (common law/case law)
 - No general concept of “income” (what characteristics have)
 - Most refer to Jordan CJ’s words in **Scott** (1935):

- Income “must be determined in accordance with the ordinary concepts and usage of mankind”
 - Examples: business salary, interest, dividend, what ordinary everyday person consider as income (Capital gain: statutory income)
- “Ordinary concepts” in Australia: does **not include**:
 - **Capital receipts**
 - **Gambling winnings**
 - **Gifts**
- Before 1986, distinction between capital gains and income: very important
 - Since CGT, still important: (no tax gain regime)
 - e.g. pre-CGT assets, 50% CGT discount, quarantine of capital losses, timing of taxation
 - (if satisfy some rules, CG it is not income—not realised, tax on realisation vs flowing; apple tree: apple: income, periodic, flow; tree—CG)

1985 Tax Reform

- 2 major “base broadening” measures:
 - (1) Capital Gains Tax (“CGT”): real broadening of income tax base (CGT regime) (tax capital loopholes, fix problem 15-2)
 - (2) Fringe Benefits Tax (“FBT”): not real broadening; instead, aimed to replace the old ineffective s. 26(e) ITAA 1936 (replaced, should refer to 15-2)
- **caution when reading tax cases**

Concepts of O.I.—4 elements—what? Who? When? Amount?

What?

- X holds an capital asset, cost=100, MV=120, still hold, MV increase. Any “income” for Mr. X?
- Realisation—Income as a flow
- Under Haig-Simons (economists) ideal: \$20 is “income”; i.e. “economic gain” concept
- However, even Simons agreed that “income” would **unlikely be taxed until realised** for practical reasons. Why? Not be taxed until sold: (not income for tax purpose)
 - No cash flow (no money to pay)
 - Market price fluctuate
 - Value (how to value) different people have different value; on realisation: sell price.

Realisation Principle

- **Not tax unrealised gains** due to:
 - Valuation
 - Cash flow
 - MV fluctuation
- Exceptions:
 - Financial instruments: TOFA, e.g, mark-to-market, fair value (financial instruments for big entities, tax on ongoing basis, can bear tax)
 - Employee share scheme (shares from employees)

Who?

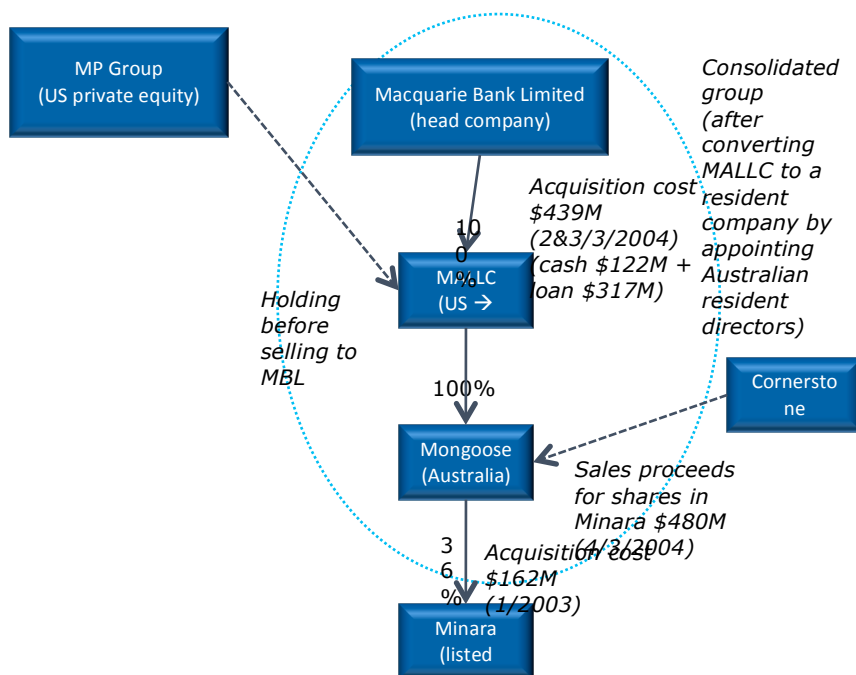
Federal Coke

- Fact: (getting the wrong taxpayer)
 - Taxpayer processed coal of parent company Bellambi for a fee (one subsidiary have coal, mine for parent, the subsidiary is the taxpayer here) (is B subject to tax for subsidiary?)
 - Bellambi had a supply contract with customer

- Customer agreed to pay Bellambi \$1M to change contract terms
- With tax advice, customer paid taxpayer instead for “the closure of the company’s coking works”
- Held: **not “income”, being capital receipts** (not change nature of income)
- Reasons:
 - Sum might be taxable to Bellambi, but the Commissioner did not adopt this basis
 - Court must decide character of receipts “in the hands of the taxpayer”, instead of Bellambi
- Commissioner identified **wrong** taxpayer
 - (Sub—capital not income (cut down whole tree))
 - B--\$go via B, B (constructive receipt) direct \$ paid on behalf, not assessable)

Macquarie Bank Limited [2013] FCAFC 13

- Under tax consolidation: (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2503235)
 - MBL: the only taxpayer in the consolidated group (100% owned consolidated regime—100% deem to be one taxpayer (consolidated group), not recognised as every company)
 - But, Mongoose would be the taxpayer that would have derived the \$318M capital gain
 - Who should be the tax payer (“Who” is really important.)
- ATO: issued “double assessments” for the same amount of tax benefit \$318M to MBL and Mongoose.



The Macquarie Bank case is possibly the modern case on the issue “who is the taxpayer.” However, it differs from Federal Coke on a critical point. While the **Commissioner failed to identify the correct taxpayer** in Federal Coke, there is **no chance that he could have identified the correct taxpayer** in Macquarie Bank. This is because, through the magic of the consolidation regime, the correct taxpayer did not exist at all.

Macquarie Bank Ltd successfully took advantage of the consolidation regime and reduced an otherwise taxable gain of \$318 million to \$41 million. The ATO challenged the arrangement under Part IVA, but was in vain. The interaction between the consolidation regime and Part IVA dictates that the company – that, in the absence of the scheme, would have made the gain of \$318 million – was no longer a taxpayer under the definition of “tax benefit” in Part IVA. Despite the desperate attempt of issuing duplicate assessments with respect to the same \$318 million gain to two different companies, the Commissioner

was doomed to defeat, as **no taxpayer could have obtained a “tax benefit”**.

This outcome defies common sense and highlights the difficult interaction between the enterprise doctrine – under which a corporate group is treated as one single enterprise for income tax purposes – and the separate entity doctrine which treats each company as a separate taxpayer, even if the company is a wholly owned subsidiary of another company. This paper first reviews the facts and decisions of the case. This is followed by the analysis of two key issues arising from the case with respect to the interaction between the consolidation regime and Part IVA: the issue of “who is the taxpayer”, and the problematic application of the definition of “tax benefit” to a consolidated group.

When?

- Tax accounting
 - 2 key words:
 - **Derived** (for income) (if not derive income, not taxable, must derive ordinary income for deductible)
 - **Incurred** (deduction)

Amount?

- Cash: currency conversion rules in **Div 960 ITAA 1997** (can pick currency)
- Non-cash: how to value? (what is the money value)
 - MV: s. 21 ITAA 1936
 - Where, upon any transaction, any consideration is paid or given otherwise than in cash, the money value of that consideration shall, for the purpose of this Act, be deemed to have been paid or given
 - Supplemented by s. 21A ITAA 1936 “non-cash” business benefits”:
 - In determining the income derived by a taxpayer, a non-cash business benefit that is not convertible to cash shall be treated as if it were convertible to cash.
- **Lemonade case: *Cooke and Sherden*** (non cash convertible, non O.I., but now **s. 21A**)
 - (Reason: measure, not actually income unless use the holiday—no benefit if waste; 2T—convertible—deem to convertible, deem to cash; anti-avoidance, reason—business may want to receive not CE—efficient rule-d—reduce tax avoidance—equity basis)
 - In *FCT v. Cooke & Sherden* 80 ATC 4140; (1980) 10 ATR 696, the gratuitous provision of a **benefit in the form of a holiday** by a soft drink **manufacturer to retailers** of its product did **not, of itself, preclude** its characterisation as the 'proceeds of a business' within the definition of 'income from personal exertion' in subsection 6(1) of the ITAA. If the benefit could be so characterised it is clear that it would be income in the hands of the recipient. As Windeyer J said in *Scott v. F C of T* (1966) 117 CLR 514 at p. 524, the definition of 'income from personal exertion' in subsection 6(1) of the ITAA:
 - In *Cooke & Sherden*, however, the Full Federal Court took the view that as the benefit conferred on the retailers was **not convertible into money or money's worth**, there was no **receipt of income according to ordinary concepts...** See 80 ATC at p. 4150; 10 ATR at p. 706. Similarly, the benefit of the interest free or low interest loans here in question, **not being convertible into money or money's worth, could not be said to be income according to ordinary concepts** notwithstanding that it may be characterised as the proceeds of a business.
 - As a result of the decision in *Cooke & Sherden* section 21A was enacted. It provides that **non-cash benefits** received from business relationships that are **not convertible into cash are treated as if they were convertible to cash and brings within the assessable income non-cash business benefits**, whether convertible or not, provided they are **of an income nature**. That is, it provides the missing characteristic that would otherwise make the benefit an income receipt. The section applies to non-cash business benefits provided after 31 August 1988. Accordingly, the section applies to benefits received under arrangements that may have been entered into before 31 August 1988, whether on a contractual basis or not, where the benefit is provided after that date.
 - Facts – Tp was in the business of distributing soft drinks. Manufacturer offered free holidays if a person was selling their product. The rights to the holiday were not transferable.
 - Q – is the value of the holiday assessable under s 6-5 or s 26(e)?
 - Held:
 - Not ordinary income under s 6-5 because benefit **cannot be converted into cash**. Section 21A (see below) did not exist at the time of this case.

- Govt introduced **s 21A** – non-cash business benefits. If received a non-cash benefit in the context of a business, **deemed to be convertible into cash**. Therefore **will be ordinary income if this case were to happen today**.

Income From Services

Categories of (ordinary) Income by Source

- Income from:
 - Provision of services (employee commission)
 - Property (dividends, cash at bank, shares)
 - Business
 - Compensation and periodic receipts (insurance)
- (Determine whether it is OI or not, put in categories first)

Income from provision of services—Steps of analysis

- Ordinary Income ?
- S.I. (e.g. CGT)?
- FBT?
- Reconciliation?

FBT

- Target:
 - **Non-cash benefits** derived from **employment** (employment loophole **s. 21**)
 - e.g. car, low interest loan, housing and meals, holiday and travel (instead of paying cash, reduce cash component)
- Possible ways to tax fringe benefits?
 - (If limited only to use for work, it is not private personal benefit, not subject to FBT.)
 - (1) As income of employee (when employer pay, need deduction, deduct car amount from salary)
 - (2) At employer level: at an arbitrary rate**
 - (3) Disallow deductions of employer: at employer's applicable tax rate (still paying cash)
- FBT regime:
 - Adopted (2)
 - At **top individual marginal rate** + Medicare levy—**49%** from 1 April 2015 to 31 March 2017
 - (highest rate, most people care cash/property—probably on top marginal rate; employer usually deduct tax from salary package)
- Problems?
 - Wrong tax amount
 - Wrong tax payer (tax employer level for employee, non-cash benefit)
 - **Double tax** exposure for expatriates (other country—“have you paid”—no, because employer paid.
- FBT Overview
- Fringe Benefits Tax Assessment Act 1986
 - Prescriptive provisions determining:
 - Is there a **fringe benefit**; (personally get in, replacing salary) (dictionary s. 136, subsection1)
 - Is it subject to FBT; (divide up into schedules, different section different rules)

- How to calculate the taxable value of the fringe benefit; and (**gross up, pre-tax position, no post**)
 - How to calculate the FBT liability;
- Tax year: 1 April to 31 March

Reconciliation

- **CGT: s. 118-20 ITAA 1997** (anti-overlap rule)
 - Other provisions: priority
- Fringe benefits:
 - NANEI: **s. 23L ITAA 1936**
 - i.e. FBT: priority (anti-overlap rule, no longer taxable under income tax)

Income From Provision of Services

- “Ordinary concepts”
- Definition of “income from personal exertion”: **s. 6(1) ITAA 1936**
- Extended by **s. 15-2 ITAA 1997** (previous s. 26(e) ITAA 1936)
- Your assessment 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 (other bonus related to employment)
- Scope **limited** by FBT (if ordinary income, not statutory income)

Nexus between services and receipts—**Hayes**

- Fact:
 - Taxpayer: employed as financial advisor of Richardson (direct rule)
 - Richardson “in a spirit of generosity” give shares in his company to taxpayer as “gift” (non-cash benefit)
 - Richardson made “gift” in recognition of past services and as an inducement for future services
- Held: **not income (gift)**
- Reasons:
 - Gratitude for service: not sole motive
 - In fact, “motive...cannot be a decision factor in cases of this kind”
 - Decisive factor: **whether the receipts was related to taxpayer’s “income producing activities”**
 - (Gift—must identify personal relationship; **Personal Relationship, already remunerated**)
 - Judge could not establish this relationship

Nexus between services and receipts—**Dixon**

- Fact:
 - Taxpayer **volunteered** for services in WWII (top up payments)
 - Former employer made **voluntary** regular payments to make up difference between military pay and his former salary
- Held: **income, but not from personal services** (get income but not doing anything)
- Reasons:
 - **Not for services** rendered (**paid already performed in the past**)
 - Payments:
 - **Periodic** and (characteristics—satisfied—yes is income)
 - Taxpayer relied on them to meet living expenses

- As **compensation receipts** for salaries (expected to get them, relied upon)

Nexus between services and receipts—Smith

- Fact:
 - **Employee** of Westpac received \$570 under “encouragement to Study **Scheme**”
 - Payment made when employee successfully **completed approved courses** on banking
- Held: **taxable under s. 26(e) ITAA 1936** (yes, it is assessable; after 3 appeals with 9 judges, with a bare majority of 5 to 4)
- Reasons:
 - **Not “personal” gift (no personal relationship)**
 - Scheme designed to improve efficiency and performance of employees
 - Scheme was “**an aspect of their employment**” (**connection with employment**, though outside duty statement)

Benefits from Non-employer—Holmes

- Fact:
 - **Sailor** employed on a tug
 - Participated in successful salvage operation of a sinking ship’s cargo
 - Entitled to reward from owner of the sinking ship under the law of Admiralty, not under his employment
- Held: **taxable under s. 26(e) ITAA 1936** (yes taxable, not taxable because of employment, but **provide service**, reward tax, subject to 15-2)
- Reasons:
 - “a right to a salvage reward is personal to the salvor who **renders the salvage service**”
 - Payment **in recognition of the services performed**
- Cf. IT 167: Radio & TV Competition Prizes
- (Nature: gamble or assessable—in scope of business; repetitive: base life outside—income; scope: e.g. footballer)
- Frequent flyer points, free flies, non-cash benefit; employee: FBT?

Benefits from Non-employer—Payne

- “frequent flyer schemes”
- **TR 93/2**
 - Value of free flights taxable to the extent the points are accumulated from business trips
 - Qantas: decided to initiate a court challenge
- Fact:
 - Payne: **employee of KPMG** (tax adviser of Qantas)
 - Disclosed in her tax return free tickets used to bring her parents from UK to Australia
- Held: **no taxable**
- Reasons:
 - Qantas provided free tickets “**not because of Payne’s employment...but because she had become entitled to it under Qantas’ own scheme**”
 - S. 26(e) not applicable
- TR 93/2: withdrawn (solely between Payne & Qantas, not part of employment, not connected with any employment)

Payments for Restrictive Covenants—Higgs v Oliver

- Fact:
 - Actor completed film Henry V (keep characteristics identifiable)
 - Agreed not to act in any other film by other movie producer for 18 months
 - Received lump sum for the agreement
 - (Promised not to do sth.; capital—cutting down the tree—cut off anything for income)
- Held: **not income** (**not for her service**, her services was to act, but now promise not to act)
- Reasons:
 - **No evidence** to support that the agreement “was a device...whereby the taxpayer obtained, as his award for playing in...Henry V, a further remuneration”
 - **Capital receipt**
 - If “it was a **regular practice** with actors to accept [such a] sum”
 - **Income** (ordinary incident)
- Now covered by CGT Event D1: **s. 104-35 ITAA 1997**

Concept of income—Part 2

(Ordinary income—(1) personal exertion; (2) property (3) business. Identify OI—AI or not)

Revision & Feedback

- Assessable income = ordinary + statutory income
- Besides the above two categories of income, the other two types of income in Australia are **exempt** and **non-assessable non-exempt income**.
- John incurred \$10,000 tax loss in this income year, and derived \$8,000 exempt income and \$3,000 non-assessable non-exempt income. His loss to be carried forward to the next income year is **2,000**. (10,000 – **8,000**, as **deduction** next year)
- Ordinary income is defined in section s. 6-5 of ITAA 1997 to be **income according to ordinary concepts**.
- If John derives \$1,000 that is both ordinary income and also taxable fringe benefit under the FBT regime, the amount will be taxed as **FBT** only. (**23L**-precident to FBT to prevent double taxation)
- FBT is imposed on **non-cash benefits** and the tax rate is **49%**. (taxable value of benefit * gross up * FBT rate) (highest marginal rate including...)
- The classic case on the issue of “who is taxpayer” is **Federal Coke**.
- An amount is ordinary income only if it has sufficient **nexus** with a source of income
- The three main sources of ordinary income are (1) property; (2) business and (3) personal exertion.
- Is a gift received by an employee from his employer is a Christmas party ordinary income to the employee? Answer: **depends on personal relationship** (absent of fact; yes: if no personal relationship; no—not OI if personal relationship)
- The **compensation (substitution)** principle states that a new stream of payment will take up the characteristic of the **original stream of payments that it replaces**.
- The concept of ordinary income in Australia in general does not include **(1) gambling; (2) capital receipts; (3) gift**.

Income from Property

- Income from **use** of property

- Interest (if bank pay interest—pay for time (what are actually paying for; time get access, time losing opportunity, time bank use \$ for) (commercial property))
- Rent
- Royalty
- Dividend
- Income from **transfer** of property
 - CGT in general (sell, tax sale of capital assets under CGT)
Ordinary I.: also possible
(Different: (1) **ongoing basis**→when CF come in over period of time (**flow**))
(2) **Realisation basis**→right at end, not until sell (**lump sum**))

Lease Premium

(pay by lessee to induce leasing, in commercial. **Not equal to replacement of rent**)

- Case law: **capital receipt** (rent)
 - Form over substance
- Legislation response:
 - **CGT Event F1: s. 104-110 ITAA 1997**
 - Capital gain = capital proceeds (i.e. premium) less related expenses
 - i.e. **whole** amount taxed **immediately**: **correct timing?** (cost, premium, upfront made immediately when enter, not include rent—OI)
 - (Montgomery Case: coding—income, not premium—it is the **ordinary way operate**, common incurred—ordinary way to earn income; ordinary business income—ordinary income; **otherwise capital**—because it is induce to be in contract) (professional firm)

Loan Discount & Premium

(Borrow lower or pay more than borrowed)

- Case law: **capital in nature**: **Lomax v Peter Dixon**
 - Form over substance
- Specific regime:
 - **TOFA: Division 230 ITAA 1997**
 - (regime only for big tax payer, only apply for financial arrangements)
- (change the lump sum to spread them (not wholly at end), flattening out to gain spread over time; if expect to get gain/fair is predicted on day 1)

Royalty

(bring to assessable income; if Royalty is Ordinary Income→s. 6-5 (ordinary income is s. 6-5 only, other else is statutory income; if capital amount→s. 15-20. Lease premium→CGT)

- **S.I.: s. 15-20 ITAA 1997**
 - Your assessable income includes an amount that you receive as...royalty within the ordinary meaning of 'royalty'...if the amount is not assessable as *ordinary income under section 6-5. (inclusive section) (ordinary meaning of revenue)
- Royalties should be payments "made in respect of the particular **exercise of the right**...and therefore should be calculated either **in respect of quantity or value taken**": McCauley
 - Examples:
 - Use of intellectual properties
 - Exploitation of nature resources (mining)
- **(1) right; (2) right exercised; (3) value measured** (trees, can enter land charge as number of tree cut)

Income from Shares

- Dividends: **s. 44 ITAA 1936** (statutory prevail unless case told, s. 6-25)
 - The assessable income of a shareholder in a company...includes...dividends (other than non-share dividends) that are paid to the shareholder **by the company out of profits** derived by it from any source...(profit company made—come back to shareholder, assessed 30% on profit) (franking credit—credit company paid)
 - **(1) shareholder on recipient (2) company (3) out of profit**
- Other receipts from shares? (resident)
 - **FCT v McNeil** [2007] HCA 5: Test case for > 80,000 taxpayers (test whether it is OI, other than dividend)

McNeil

- Fact:
 - Taxpayer: 90 year old widow; Amount: \$576.64
 - Nature:
 - St. George Bank **capital reduction scheme** (try to reduce shares, can have rights to get premium)
 - 1 for 20 “**Sell Back Rights**” (i.e. **put option**) at premium price (19%) listed on ASX
 - Options for shareholders:
 - (1) Exercise rights to sell back shares→disposal gain
 - (2) Sell rights on ASX→disposal gain (sell—taxed CGT, sell rights)
 - (3) Do nothing→St George sold rights on behalf of shareholders and credited proceeds to shareholders
 - Rationale: Same benefit to **all shareholders**
- Decision:
 - First instance: not income nor CGT
 - Reason:
 - Gain: not out of profits
 - CGT: Provision too complex
 - “I would venture to suggest that the Legislature would not have reasonably contemplated the operation adversely to a taxpayer of circumstances in which a passive taxpayer ... would become exposed to capital gains tax...” (tax will not tax you if not know will be taxed)
- Full Federal Court (2:1): ditto
 - Reason:
 - Gain:
 - **Out of capital reduction scheme**
 - Not dividend out of profits
 - CGT Event H2: not ‘act, transaction or event’ **in relation to** the share (instead to the taxpayer as shareholder)
- High court (4:1): **income** (no comment on CGT)
 - Reason:
 - Sell back rights: granted “**for the absolute benefit**” of taxpayer
 - **MV of rights: income**
 - **(Capacity of person; capacity of shareholder; receiving in that capacity—shareholder—income from property; the capacity of person receiving it—taxed)**
 - (The majority decision in McNeil was that the value of such rights **would be regarded as ordinary income** in the hands of the bank’s shareholders at the time the rights were issued.)

- Principle:
 - **Nature of income:**
 - Depends on quality in hands of recipient, not other parties (i.e. capital reduction scheme: irrelevant)
- Potential application to call options:
 - Government response: **s. 59-40 ITAA 1997**
 - Effect: m.v. of **call options** at issue time: **NANEI** (not assessable, not exempt)
 - i.e. prevent accelerated taxation of unrealised gain
 - Conditions: include:
 - option issued on existing shareholders
 - shares held on capital account
 - shares not acquired under ESS (Employee share scheme) (bonus shares + cash for employee)

(grey area—hobby or business-depend on activities carry out on regular basis)

Income from Business

What is a “Business”?

- Definition: **s. 995-1(1) ITAA 1997**
 - Business includes any profession, trade, employment, vocation or calling, but does **not include occupation as an employee** (rule out) (“**XX IS Employee**”—not talking about business)
- A “question of fact”
 - **Relevant factors?** (Weight out, which is more weight)
 - **Company** = person/ individual, it **carry on a business**: sth. You do v. sth. Carry on, care wording)
- **6 badges of “trade”**: Final Report of the Royal Commission on the Taxation of Profits and Income (UK 1955) (not conclusive)
 - **Subject matter** of the trade
 - E.g. 1M rolls of toilet paper: Rutledge (massive quantity)
 - Length of period of ownership (ongoing basis, repetition, regular—if one off; within scope of business, or so few, not carry on)
 - Number and frequency of similar transactions
 - Supplementary work (work did to set up business)
 - Circumstances surrounding the sale (what is selling—consulting/know how; anything go with business do)
 - Motive (intention)
- Additional factors:
 - Organisation of activities in **businesslike manner** (keep records, regular basis)
 - **Size** of operation (not exclude small things)
 - **Capital** employed (significant investment in capital assets, although no income, amounts to set up)

TR 97/11

- Indicators suggesting a business: (<http://law.ato.gov.au/pdf/pbr/tr1997-011.pdf>)
 - Significant commercial activity (transaction at commercial level)
 - Profit-making **motive** (***)not equal to how much, the more you do, the more likely, even \$1 is enough) (not mean every year profitable, in the past, projections (sales/marketing/management)—evidence, carry a lot of way)

- Repetition & regularity
- Organised in **businesslike manner** (systematic hedge, record keeping, documentation commercial)
- Size and scale of operation (the larger the size and scale, the more likely to be business)
- Hobby/ recreation (authors, artists, not realise, grey area, question of fact)

Example 3 - significant commercial purpose or character

Naida and her family kept twelve chickens. Twelve was the minimum that she liked to have around. She knew that her relatives and friends liked her home grown eggs, especially the double yolks that were often produced. The chickens produced about six dozen eggs per week. Of these Naida and her family consumed one dozen. She sold the remaining five dozen eggs to relatives and friends. She found that after taking into account her direct feed costs she usually managed, in her estimation, to make a modest profit of \$5.00 per week. Was Naida carrying on the business of egg production?

No. Even though she had repetition and regularity in her operations and was making a modest gross profit:

- she was not conducting the activity in the same way as that of a commercial poultry farmer;
- she did not try to sell in a commercial market;
- she did not seek the best price for her eggs;
- she did not sell chickens that were culled because of falling productivity;
- the scale of her operations were such that she could never produce a net profit;
- she had not conducted any research into the egg industry; and
- She had not looked at the full costs of production and distribution in determining the commercial viability of her enterprise.
- (A: regular basis, consistently, repetitive, documentation, feed cost, estimate profit, why keep chicken—motive—\$ not just for money or not really about money; CA: size small, family and friend—not commercial way to sell)

If Naida's activities changed significantly and she: had considerably more chickens; sold the eggs to the public at large at market prices or to retail egg sellers; and established by research that this level of activity was profitable after taking all her costs into account; this would point to a significant commercial character and a profit motive. She may then be carrying on a business of egg production.

Example 5 - the intention of the taxpayer

Lindsay and Loretta bought 700 hectares of run down rural land in 1980. They intended to start a cattle farming business. Over the next five years they spent several thousand dollars on farm machinery. They used this to clear the land, build roads and mend fences. They also bought and erected some farm buildings. No income was derived from the property until 1986 when they stocked the property with 100 cattle. Were Lindsay and Loretta carrying on a business from 1980 to 1985?

No, because:

- the activities of Lindsay and Loretta from 1980 to 1985 would be regarded as **preparatory** to the commencement of business;
- whilst they had a clear purpose to engage in cattle farming, they recognised that certain things needed to be done to the land before they were able to buy the cattle and put them on the land;
- until 1986 there was no size or scale of the relevant activity in the sense that there was no stock; and
- There was no repetition or regularity of activity with respect to cattle farming until the land was stocked.

Example 7 - prospect of profit

Fay's friends were avid growers of olive trees and were making a small profit on the sale of olive oil they produced from their olives. Fay decided to grow olive trees on her modest property. She researched the varieties and selected those best for olive oil production. Fay planted 50 olive trees on her property. She knew they were hardy trees which required minimum maintenance. She spent the minimum amount of time necessary to care for the trees. She had spoken to her friends and had calculated that after four years she would be able to make a profit on the production of olive oil from the olives she picked. The trees thrived. In the fifth year after planting, a sizeable crop was produced. Fay employed casual labour to pick the olives, borrowed a friend's trailer and took the olives to be pressed. She sold the barrels of olive oil to friends, work colleagues and members of the public who responded to her newspaper advertisements. She derived a substantial profit in that year, which she was told by her friends in the industry was typical. Was Fay carrying on a business of olive production?

Yes. The activities were carried out **with a purpose to make a profit, even if no income** was made in the first four years of operation. In addition:

- Fay clearly had a plan to make the activity succeed. She had conducted research by consulting friends in the industry and the local growers association;
- Though the activity was small it was organised. By its nature the activity required minimum maintenance. It was not carried on in an ad hoc manner. Rather, it was carried on in a manner similar to that of other olive producers; and
- There was repetition and regularity of the activity.

Illegal Activities

- Can illegal activities constitute a business? (Decision: **not matter illegal**, and allow for deduction)
- ATO position: **TR 93/25** <http://law.ato.gov.au/pdf/pbr/tr1993-025.pdf>
- (Drug carrying business. La Ruser tax act not to punish crime, still look at the same factors, not require have to be legal)

Business v Hobby

- Business: proceeds taxable; **expenses deductible** (assessable and deductible)
- Hobby: opposite (recreation proceeds not taxable (assessable), **expenses not deductible**)
- ATO: argue for business or hobby?

Martin v FCT (1953) 90 CLR 470

- Fact: (gamblers)
 - Taxpayer: regular punter, developed punting system on racehorses
 - Recorded details of all bets and results
- Issue: "business"?
- Held: **not business** (**not closely connected with his business**)
- Reasons:
 - Just "find pleasure in betting" (just hobby)
 - A mere punter

Similar judgement in **Evans** (just hobby)

Stone [2005] HCA 21

- Fact:
 - World class javelin thrower and full time employee of police service (employed as full time)
- Received:

- (1) prize money: \$93,429 (net of foreign tax)
- (2) grants from Academy of Sports: \$27,900
- (3) appearance fee: \$2,700 and
- (4) sponsorships: \$12,419
- (part of professional sport business **admitted**—is business—other things come to the part fall into business connected)
- Joanna Stone’s argument:
 - Not conducting a business
 - Sole motivation: desire to excel and represent Australia
- Held:
 - Full Federal court: only (3) & (4) taxable
 - High Court: all taxable
- Reasons:
 - “sport” vs “**professional sport**” → “**business**” (turn talent to account)
 - Sponsorship: taxpayer accepted as **assessable** income
 - “the conclusion that she had **turned her sporting ability to account** for money is **inevitable**” (the rest is **all connected** and all business)
 - “excellence in sport” & financial advantage: can co-exist
 - Counter argument?
- Effect: loss claim

Division 35 ITAA 1997

- Targets: (“business”)
 - Agricultural and forestry schemes, hobby farms (prevent people any on loss—offset profit)
 - “**non-commercial losses**” rules: (**non commercial loss provision**) (one loss against income from another activity)
 - “This Division prevents **losses of individuals from non-commercial business activities** being **offset** against other assessable income in the year the loss is incurred. The **loss is deferred**. It sets out an income requirement and a series of tests to determine whether a business activity is treated as being non-commercial.
The deferred losses may be offset in later years against profits from the activity. They may also be **offset against other income** if the income **requirement** and **one of the other tests are satisfied**, or if the **Commissioner exercises a discretion.**”
 - Applicable to individuals if
 - **Deduction > A.I.** for the “business activity” in a year **unless** satisfying one of the **exceptions** (unless not apply)
 - Effect:
 - Defer losses
 - Loss quarantine (**only offset from that activity**)
- Exceptions: (not apply)
 - A.I. of activity \geq \$20,000
 - Profits in 3 out of last 5 years
 - Cost/ m.v. of business real property \geq \$500,000
 - Value of business assets (excluding real property and cars) \geq \$100,000
 - For primary producers and artists: (encourage)
 - Other A.I. (excluding CGT) $<$ \$40,000
- Exceptions apply only if:
 - **Adjusted TI** (include T.I. and fringe benefits, etc.) \leq **\$250,000**

- Commissioner's discretion (e.g. **start-up phase**) (will be commercial business)

Ferguson

- Fact:
 - Naval officer leases 5 cattle
 - Paid a manager to look after them on property owned by manager
 - Maintained detailed records of cattle, receipts and payments
- Issue: carry on a business?
- Decision: **Yes**—"embarked on a **commercial activity**...conducted **systematically** and ... in a **businesslike manner**. (because **intention**—make money)

Walker: (even one goat is enough) FCT v Walker (1985) 85 ATC 4179

- This case considered the issue of carrying on a business and whether or not a man was **carrying on a business** of primary production even though he **had only purchased one** animal and had **not made a profit**
- (never success, member of society; Yes—systematically business way, projection plan, research everything, in **commercial manner**)
- The case of JR Walker involved five Angora goats, two of which died. Whilst the scale was small, the court held that a goat breeding business **was being carried on** because **there was a profit making purpose** and **repetition and regularity** in the taxpayer's activities. Research, based on authenticated sources, showed that a profit could be made from **the significant capital allocated** to breeding stock.

Extraordinary Transaction

(Not un-assessable, can still be assessable income even though not usually do)

- Possible tax implications:
 - Ordinary income: **s. 6-5 ITAA 1997**
 - Statutory income: **s. 15-15 ITAA 1997**
 - Your assessable income includes profit arising from the carrying on or carrying out of a profit-making undertaking or plan
 - Exclusions: O.I. for sale of post-CGT assets
- CGT (captured)

Whitfords Beach***

- Fact:
 - Company purchased land in 1954 (pre-CGT—completely not taxed on capital)
 - Shareholders enjoyed access to fishing shacks on the beach
 - Shareholders sold all shares to property developers in 1967
 - Company proceeded to develop and subdivide land, and changed company articles accordingly
 - (3 fish men built a company (a person), the company is a taxpayer, company own a block of land (buy land for not block view); Sell shares (pre-CGT) tax free—new shareholders became P1P2P3; Change constitution, Ps are carrying on property development business, company sell land—lots of profit—is it O.I.?)
 - (Property developer, but it is the **company profit**; when **change constitution, company start to carry on business**—even though isolated transaction—YES)
- Held: **Ordinary income**
- Reasons:

- Change of shareholders in 1967: very important event
 - If no change, may be capital (because **change constitution**, change mind of company)
- Since 1967, “the taxpayer was **transformed** from a company which held land for **domestic purposes** of its shareholders to a company whose purpose was to engage in a **commercial venture with a view of profit.**”

Myer Emporium

- Fact: [**tax effective financing scheme**]
 - Myer lent \$80M to its subsidiary at 12.5% interest (want to raise funds, set up subsidiary, make loans to subsidiary payable, CF interest—make loan on, borrow from bank)
 - 3 days later, assigned right to receive interest stream for \$45M
 - Taxpayer argument
 - **Outside ordinary retailer business** (not money company)
 - Sale of capital asset
- Held: **Ordinary Income**
- Reasons:
 - **Though outside ordinary scope** of business, a gain from extraordinary transaction “with the **intention ... of making a profit**...may well constitute income” (even though first time)
 - **Lump sum in exchange for future interest: revenue (substitute to interest—take nature to interest—income)**
- Now covered by *s. 102CA ITAA 1936* (profit commercial way)
- **TR 92/3** (<http://law.ato.gov.au/pdf/pbr/tr1992-003.pdf>)
 - Profit from an **isolated** transaction would in general be income if
 - (1) **Profit making motive** and
 - (2) The transaction **amounts to a business** (transaction itself is business)
- Concepts of “income” **extended** by Myer?
 - Clarified by **Westfield** case (extend scope of income, recognise: any time make profit—ordinary income)

Westfield

- Fact:
 - Taxpayer **bought land intended for development** in conjunction with an existing centre
 - **Subsequently sold** land to owner of existing centre on condition that it be engaged to design, build and manage new shopping centre on the site (O.I. or CG?) (Shopping centre, sell off not develop)
- **Held: Not income**
- Reasons:
 - “It does not follow from...**Myer**...that every profit made by a taxpayer in the course of his business will be of income nature”
 - **Profit-making motive**: very important factor (carry business intention to profit—enter transaction and make profit—OI—same as **intention**)
 - (**Profit not from intention of profit**, buy land expect rent revenue but not sell)
 - **Land not purchased for resale**
 - **Capital asset** (on capital account)
- CGT implication—**Event A1**

Sale of Business Assets

Moneyman

- Fact:
 - Taxpayer sold long-term milk supply contract (the major asset of the business) **for a series of payments** over 20 years
 - Payments, payable monthly, calculated based prevailing market milk prices (time of entering into transaction is important)
- Held: **income (in nature)**
- Reasons:
 - Taxpayer “sold its **capital asset** for a **stream of income**”: *Egerton-Warburton, Phillips*
 - Monthly payments were “**a substitute for the income**” which the taxpayer could have derived...”(substitute to stream)
- CGT implication?

Capital Gain Tax

Revision and Feedback

- What is the common law definition of a royalty? Provide an example.
Payments for leases of rights (1) Rights granted A→B (2) Rights exercised (3) Fee charged for granted; Payment measured (calculated by amount take); e.g. right to enter land, cut down tree. McCauley case
- Explain the difference between a hobby and a business
Organised in manner consistent with business; businesslike way, profit motive (hobby do not have **profit-making motive** (egg case); frequently engage in activity; size; scale
- In determining whether a business has commenced, the taxpayer must:
e.g. grow apple tree/ sell apple, feasible? Carry on business; feasibility study/ expect not carry on business; not need generate of revenue; objective/ enter into by capital investing (apple seeds)→at what point→ not paid but negotiated→if study results→yes→point make decision→point of commitment; to carry on→**decide to carry on business →start to take further action**
- Provide an overview and explain the principle from the *Whitefords Beach* case.
Fishman buy land in name of company→taxpayer, hold land in capital account; developer buy shares→not sell of land, still land on capital account (pre-CGT. If sell land—no CGT); motive of company→look directors behind→ordinary income, active is profit generating activity.
- Provide an overview and explain each strand of **Myer's** case.
Income stream→“**lump sum**” **take nature**—2nd
Assignment of interest to Citibank is agreed before loan to subsidiary→loan created income stream, created asset, if not agreed ahead, Citibank will not accept.
- Provide an overview and explain Westfield's case.
Land for rent income→sell land, **not make profit in the way mean to make it**, in another way→land in capital account; if business is in buying and selling land→ordinary income.
- Are lease incentive receipts typically ordinary income? Explain why.
Not OI, not revenue; if ordinary recurrent→Westfield→OI; more frequent do→ordinary activity→s. 6-5; case
But if oneoff, never happen before, induce the structure of tree, not recurrent, getting contract, having tree being established

Capital Gains Tax—Overview

- Part 3-1 ITAA 1997 (Div 100) General rules + core provisions (start, core+3 special rules)
- Part 3-3 ITAA 1997 special rules/ topics
- Assessable income = ordinary income + statutory income (**layer, methorital—go to division—category)
- **Net** capital gain (not capital gain) is a form of **statutory income**: s. 102-5 (5 CGs—add up to NCG) (all gain and losses, gain from one transaction, calculate to be included in AI)
- Relies on the concept of “CGT event” (identify 1st—has to be CGT event)
- Introduced in September 1985 and therefore generally applies only to assets acquired **after 19 September 1985** (CGT Not apply, exemption)
- Problem with pre- and post-CGT asset system? (Difference of day, in equity, not as you go, on realisation, prevent people sell asset)
- **Equity**: favours existing owners; **efficiency**: “lock-in”; **simplicity**: complex legislation
- Wealth tax: adjust for inflation (increase of wealth)

Net Capital Gain

s. 102-5(1):

- Assessable income includes your **net capital gain** (not 100, 102—operative section, p. 943)
- See method statement to calculate **Net capital gain**: 4 steps (section)

Method statement to calculate net capital gain

<p>Step1: calculate CG/CL from each CGT event and apply capital loss against capital gains (note rules about collectables)</p> <p>Permitted to index cost base. However, if index cost base, cannot use discount. (net off/ not use CL as deduction) (adjust for inflation, adjust cost base for smaller gain, increase cost, only use one or the other, depend on satisfaction)</p> <p>(identify CGT event—section go to—follow rules in that event)</p>
<p>Step2: Apply prior year net capital loss against any remaining capital gain (note rules about collectables)</p> <p>(if negative—carry forward—net capital loss, against this year gain—\$1000 year1—against \$2000 year2; CL only offset against CG)</p>
<p>Step3: discount any CG that is eligible for discount if asset held for at least 12 months</p> <p>Individuals & Trust—50% (half of gain); complying super fund—33 1/3% (already has concessional rate); company=0</p> <p>(1) not company</p> <p>(2) hold asset >=12 months; (% depend on type of individual)</p>
<p>Step4: Apply small business concession</p>
<p>Result step (5): net CG included in assessable income. Note CL is not included)</p>

Step 1: Calculating capital gains and losses

Capital Gains & Capital Losses

- When do you make a capital gain/capital loss?
 - If and only if a **CGT event** happens **s102-20(1)**
- CGT event:
 - Table of all CGT events: **s104-5** (not operative, not cite, just a list, Division 104, only for CGT; “s. 104-10”—operative—must cite if want to refer, all section is Div. 104)

- If **more than 1** CGT event can happen, use the event that is **most specific** to your situation s102-25(1) (no golden rule—judgment, e.g. sell of trust—trust—rule: not going tax twice)
- CGT events D1 and H2 are **last resort**
- CGT event **D1** takes priority over CGT event H2 (D1 applies, flexibility and choice)
- Timing of CGT event: **s104-10(3)**
 - Entry into disposal contract
 - If no contract, change of ownership
 - If several contracts lead to the acquisition of an asset, only the contract that results in the direct transfer is relevant for determining the time of acquisition of the CGT asset: Elmslie v FCT
 - Oral contracts are relevant for CGT purposes (no evidence)
 - Conveyance of **land** must be in writing to be enforceable: s54A Conveyancing Act 1919 (NSW)
 - Oral contract is still a contract for Div 109; McDonald v FCT

CGT event	<ul style="list-style-type: none"> • CGT events are contained in Div 104. Common ones include: <ul style="list-style-type: none"> • A events – disposals (sell shares) • C events – ending of an asset • D events – creation of assets • E events – trust • F events – leases • I events - residency • G events – shares (focus on residential company granting shares, capital returns because hold shares, not disposal) • H events – special receipts
Calculate Gain/loss	<ul style="list-style-type: none"> • Each CGT event has its own rules in calculating the gain / loss. Important to follow. • Broadly: (get-pay) (follow each) Gain = capital proceeds - cost base Loss = Reduced cost base – capital proceeds (pay more than receive) • Capital gains cannot be discounted at this stage. However, merely note which are eligible (step3—insert later wame)
Exemptions?	<ul style="list-style-type: none"> • General exemption for assets acquired before 20/9/1985 (pre-CGT asset, exempt in each CGT event—for each event, a subsection104+015) • Other exemptions contained in Div 118 (all about exemption) (proxy—to see what is better method)
Rollover?	<ul style="list-style-type: none"> • Same asset rollovers: e.g. marriage breakdown 126-A • Replacement asset rollovers: e.g. Scrip for scrip 124-M; (different shares for different position of company) • Sell assets, defer payments (upgrade factory, pay when sell new factory—rollover to later point of time)

CGT Event A1 (s. 104-10)	<ul style="list-style-type: none"> • What: disposal of CGT asset (change in ownership). (basic sell) • Exception: change in trustee (legal owner, but not disposal) • Time of event: If there is a contract, when contract entered into. Otherwise, when change in ownership occurs (when sell asset, not settlement occurs) (time—year 	<p>Example A1: On 1 July 2011, Brad enters into contract to sell shares to Angel for \$1,000. The cost of the shares was \$800. Settlement occurred on 17 July 2011.</p>
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	<p>to put CG into—sell of real estate</p> <ul style="list-style-type: none"> • Gain: Capital proceeds > cost base • Loss: Capital proceeds < reduced cost base • Exemption: < 20/9/1985 (pre CGT) 	
CGT Event C1 (s. 104-20)	<ul style="list-style-type: none"> • What: loss or destruction of CGT asset (factory) • Time of event: When compensation first received. Otherwise, when loss or destruction occur • Gain: capital proceeds > cost base • Loss: capital proceeds < reduced cost base • Exemption: < 20/9/1985 	<p>CGT Event C1</p> <p>On 20 July 2012, bushfires destroyed our factory which cost \$100,000. The factory was insured and we received insurance payout for \$30,000 on 1 August 2012. (CGT event happen? Time: first receive)</p>
CGT Event C2 (s. 104-25)	<ul style="list-style-type: none"> • What: intangible asset ends by: (must be in those ways) <ul style="list-style-type: none"> ○ redeemed or cancelled; ○ Expiring; ○ Abandoned, surrendered, forfeited; ○ Option - exercised • Time of event: when contract entered to end asset. Otherwise, when asset ends • Gain: capital proceeds > cost base • Loss: capital proceeds < reduced cost base • Exemption: < 20/9/1985 	<p>CGT Event C2</p> <p>Bob received \$50,000 from entering into a 3 year restrictive covenant that prevents him from competing with Timothy. The restrictive covenant ends on 16 August 2012 (promise not to do)</p>
CGT Event C3 (s. 104-30)	<ul style="list-style-type: none"> • What: Option in shares or debentures in company granted by the company is lapse, cancelled, abandoned. Also applies to units in Trust. (option/shares expires) • Time of event: When option ends • Gain: Company / trust makes gain if capital proceeds > cost of granting (who the taxpayer is) • Loss: Capital proceeds < cost of granting • Exemption: If option granted < 20/9/1985 	<p>Example C3</p> <p>Big T Pty Ltd grants option to Thomas for \$100 consideration. It incurred legal costs of \$25. The options allow Thomas to acquire shares from Big T Pty Ltd. The options lapsed on 15 August 2012. (When ends) (right created, right to sue)</p>
CGT Event D1 (s. 104-35)	<ul style="list-style-type: none"> • What: create contractual right or other legal or equitable right in another entity. (I create rights in another entity**) • Exception: <ul style="list-style-type: none"> ○ Must consider all other events (other than H2) ○ Right – borrowing money; ○ Right requires you to do something that is CGT event ○ Issues shares / units / options • Time of event: contract entered into • Gain: capital proceeds > incidental cost (cost of enter in transactions, not actually have asset, no cost base, rights bring assets exist) • Loss: capital proceeds < incidental cost 	<p>Example D2:</p> <p>On 1 August 2012, Bob received \$50,000 from entering into a restrictive covenant that prevents him from competing with Timothy. (Bob created contractual rights for T to sue him, Bob created rights on T, receive 50,000)</p>
CGT Event D2	<ul style="list-style-type: none"> • What: granting an option (other than 	<p>Example D2:</p>

(s. 104-40)	<p>those granted by a company / trust over their shares / units)</p> <ul style="list-style-type: none"> • Time of event: when option granted • Gain: capital proceeds > cost of granting • Loss: capital proceeds < cost of granting • Exemption: < 20/9/1985 	Rania grants an option to Annie that allows Annie to purchase a Mercedes Benz from Rania for \$50,000. Annie paid \$1,000 to Rania (cost=1000 of granting)
CGT Event F4 (s. 104-125)	<ul style="list-style-type: none"> • What: Lessee receives money to vary or waive a term of the lease. • Time of event: when lease term is waived or varied. • Gain: capital proceeds < lease's cost base. Proceeds reduces cost base. • Loss: n/a • Exemption: If lease granted < 20/9/1985 	Lessee agrees to vary a term of the lease. In return, lessor paid \$1,000 to lessee. (reduce time for 4 months for shorting term of lease) F→lease
CGT Event F5 (s. 104-130)	<ul style="list-style-type: none"> • What: lessor receives money to vary or waive a term of the lease. • Time of event: when lease term is waived or varied • Gain: capital proceeds > cost of varying / waiving • Loss: capital proceeds < cost of varying / waiving • Exemption: lease granted < 20/9/1985 	Lessor agrees to vary a term of the lease. In return, the lessee paid \$1,000 to the lessor. The lessor incurred \$100 in incidental costs to vary the agreement (lessee pay to lessor) (pay for pets allowed)
CGT Event G1 (s. 104-135)	<ul style="list-style-type: none"> • What: capital returns by companies (not share buy backs) (shares hold, hold shares, capital payments, not dividend) • Time of event: when payment is made • Gain: capital proceeds > cost base of shares. Payments will reduce cost base (reduce cost base to 0) • Loss: n/a (reduce cost base→0; left over—capital gain) • Exemption: shares < 20/9/1985 	A Pty Ltd agrees to make a capital return of \$1/share. Mr T is a shareholder. The cost base of Mr T's share was \$1.50 prior to the capital return. (A \$1 paid to T) (cost base=1.5, \$1 capital return—cost base—50 cents, gain if capital return > cost of shares; if receive \$2, CB=0 , 50→gain) (cost base reduced to 50 cents; if receive \$2→male gain)
CGT Event G3 (s. 104-145)	<ul style="list-style-type: none"> • What: liquidator / administrator declares shares to be worthless. • Time of event: when declaration made (written and issued) • Gain: n/a • Loss: reduced cost base • Exemption: If shares < 20/9/1985 	Michael bought One.Tel shares for \$500. On 15 June 2012, the administrator declared the shares to be worthless.
CGT Event H1 (s. 104-150)	<ul style="list-style-type: none"> • What: deposit paid to you is forfeited because prospective sale does not proceed. (not actual) • Time of event: when deposit forfeited. • Gain: capital proceeds > cost in connection with prospective sale • Loss: capital proceeds < cost in connection 	Mona enters into a contract of sale for \$300k whereby Julie pays 10% deposit. Julie fails to complete and the deposit is forfeited. (deposit will be part of actual sell of property) (deposit actually sell, sell asset)

	<p>with prospective sale.</p> <ul style="list-style-type: none"> (not always H1) 	H1 X → event not occur → part of proceeds is 10% receive Julie, include in deposit, not residual category)
CGT Event H2 (s. 104-155) Residual	<ul style="list-style-type: none"> What: act, transaction or event occurs in relation to CGT asset you own and does not involve an adjustment to cost base Exception: consider all other CGT events first. Also, all the other exceptions to D1 apply. Time of event: when payment is made Gain: capital proceeds > incidental costs (not cost base, event in relation to land/factory) Loss: capital proceeds < incidental costs 	Stephanie owns land on which she intends to construct a factory. Another business pays Stephanie \$50k as inducement to start early. No rights or obligations are created.

CGT Asset

- s. 108-5:** any kind of property; or (definition is very broad)
- A legal or equitable right that is not property (for currency, early, everything)
- Examples: Land and buildings, shares in a company, goodwill...

Separate assets: Subdiv 108-D	Collectables: 108-10	Personal use assets: s. 108-20
<ul style="list-style-type: none"> Building or structure constructed on pre-CGT land (certain classes; build on land; fixture build on land—land, but not work in tax; depreciable building itself & things inside, separate out assets) Depreciating asset that is part of the building (separate from building) Adjacent land acquired next to pre-CGT land and subsequently amalgamated. (2 lands—pre/not—can still keep pre-land) Improvements to CGT asset where cost of improvement > improvement threshold and > 5% of proceeds when CGT asset sold 	<ul style="list-style-type: none"> Artwork, jewellery, an antique, or coin or medallion; Rare folio or manuscript; A postage stamp Used or kept mainly for your (or your associate's) personal use or enjoyment Capital loss from collectable can only be offset against gain from collectable Note collectable < or = \$500 is exempt: 118-10 A set of collectables is 1 CGT asset: 108-15 (exhaustive list; quarantine, collectable capital loss, offset losses against collectable CG itself, not other categories assets (shares...)) (if set of collectable, identical asset, 1 asset, not 6) 	<ul style="list-style-type: none"> Used or kept mainly for personal use or enjoyment Cannot make a capital loss from personal use assets: 108-20 (in house, not use loss for offset gain—sell is second hand, must loss value → not capital loss (upgrade assets)) Capital gain on personal use asset ignored it 1st element cost base < or = \$10,000: 118-10 A set of personal use assets is 1 CGT asset: 108-25 (unless a set < threshold) (table)

Capital Proceeds

General rule: s. 116-20	<ul style="list-style-type: none"> Money received or entitled to receive Market value of any property received or entitled to receive (received from purchaser, & cost base, reduced CB&CP) (include instalment, even not received)
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Modification 1: Market value Substitution rule. s. 116-30	<ul style="list-style-type: none"> Received no capital proceeds → market value substituted Receive CPs: (substitute to market value) <ul style="list-style-type: none"> some of the proceeds cannot be valued; or CP <> MV, and did not deal at arm's length (prevent arbitrage between tax rates, give to relative, within family) (Value, given in kind—still subject to MV)
Modification 2: Apportionment Rule s. 116-40	<ul style="list-style-type: none"> CP relates to more than 1 CGT event – apportion between CGT events
Modification 3: Non-receipt rule s. 116-45	<ul style="list-style-type: none"> CP reduced if not going to receive some CP, not at fault, and tried to get the amount paid. (R: entitle to receive instalment—not receive, can reduce CP)
Modification 4: Repaid rule s. 116-50	<ul style="list-style-type: none"> CP reduced by amount you have to repay (unless you can deduct those amounts) (reduce to price actually received)
Modification 5: Assumption of liability. s. 116-55	<ul style="list-style-type: none"> CP increased if the other entity acquires the CGT asset subject to a liability (own mortgage, liability not pass on, if transfer to you as new owner, s. 116-25 only apply to certain CGT events)
Modification 6: Misappropriate rule. s116-60	<ul style="list-style-type: none"> CP reduced if employee misappropriates the proceeds

Note: these modifications only apply to some CGT events: see table in **s. 116-25**

Cost Base

Element 1: s. 110-25(2)	<ul style="list-style-type: none"> Money paid or required to pay (for asset) Market value of property given or required to give (property value)
Element 2: s. 110-25(3)	<ul style="list-style-type: none"> Incidental costs to acquire asset or relate to the CGT event Consultant fees Transfer cost Stamp duty Advertising Valuation cost Search fees Conveyancing Kits Borrowing expenses (est fees) Certain consol expenditure (legal fees, establishment fee)
Element 3: s. 110-25(4)	<ul style="list-style-type: none"> Cost of owning the asset Interest on borrowing (loan) Repair costs rates or land tax <p>Note these may be deductible outright. If they are, they cannot be included here.</p> <p>(ongoing cost if asset is rent, rent already ordinary income from property, repetition, not capital in nature, not deductible; if in deductible, not here, if property produce income, usually ongoing, deductible—not use Element 3)</p>
Element 4: s. 110-25(5)	<ul style="list-style-type: none"> Capital expenditure incurred: For purpose or expected effect of increasing or preserving asset value; or Relates to moving the CGT asset (extension to a house)
Element 5: s. 110-25(6)	<ul style="list-style-type: none"> Capital expenditure to establish, preserve or defend title to asset. (lawyer fees)

- Note: Certain costs above cannot be included: **110-37, 110-38, 110-40, 110-45**
- Add up** 5 elements → Cost Base
- If holiday house—no income—all costs are deductible—Element 3

Cost Base Modification

Modification 1: s. 112-20 Market value substitution	<ul style="list-style-type: none"> • Market value substituted if no expenditure incurred • Some or all of the expenditure cannot be valued; • Did not deal at arm's length
Modification 2: s. 112-25 Split, changed/ merged asset	<ul style="list-style-type: none"> • Splits – apportion in a reasonable way. No methodology provided • Merged assets – cost base added together • (Push across events)
Modification 3: s. 112-30 Apportionment	<ul style="list-style-type: none"> • Expenditure relates to 2 or more things, apportion on a reasonable basis • Cost base of CGT asset x Proceeds from sale / (proceeds from sale + MV of remaining bit) • If CGT event happens only to 1 part of CGT asset, but not the other, apportionment based on market values.
Modification 4: s. 112-35 Assumption of liability	<ul style="list-style-type: none"> • Increase cost base by the liability of the other entity that you assume.

Indexation

- To index cost base: (inflation)
cost base element x indexation factor
Indexation factor = **68.7 (being indexation at 30/9/1999)** (quarter) (given, not change)
(tax on increase in MV, part is inflation, if increase CB in inflated amount → not tax on inflation amount; element by element basis)
CPI factor for quarter when expenditure incurred (look up index for the quarter)
- Indexation **only available** for assets acquired **before 21/9/99** (final quarter available)
- Indexation is to increase cost base for inflation
- Indexation is frozen at 30 September 1999.
- Each element of the cost base is indexed from the date it is incurred (if indexation is chosen).
- Indexation factor must be **rounded to 3 decimal places**.
- Do not index if the indexation **factor is 1 or less**: s960-270(2) (so that increase CB and decrease gain)
- Note exception for share in company or unit in unit trust: 960-275(3)
- **No** indexation of **element 3** or **reduced cost base** (elements, ongoing costs, incidental costs; inflation never contribute to CL)
- Note: CPI figures in textbook have changed
- (instead—discount; new discount figure 50%)

Reduced Cost Base

Elements: s. 110-55	<ul style="list-style-type: none"> • Same as cost base except cannot index any elements and element 3 is replaced. (never indexed) (element to element base—add up 0) • Element 3 replaced with: (NO element 3) • Balancing adjustments which result in assessable income (writing back depreciation)
Modifications: Division 112	<ul style="list-style-type: none"> • Modifications for Cost base applies to reduced cost base • Also the same sections
Relevance?	<ul style="list-style-type: none"> • Only relevant in determining capital loss (Calculate CL, not use CB, use RCB)

Exemptions

Cars: s. 118-5	<ul style="list-style-type: none"> Disregard any CG or CL for cars, motor cycle or similar vehicle
Collectables & personal use assets: s. 118-10	<ul style="list-style-type: none"> Collectables with first element of cost base < \$500 disregarded (CB not CG amount) Personal use assets with cost base < \$10,000 disregarded. Note losses disregarded (gain)
Otherwise assessable: s. 118-20	<ul style="list-style-type: none"> If the gain is otherwise assessable outside of CGT, gain disregarded (anti-overlap, OI or SI, capture elsewhere)
Depreciating assets: s. 118-24	<ul style="list-style-type: none"> Gain on depreciating asset disregarded. Subject to balancing adjustment in Div 40 (depreciate asset, but not whole for produce—part private purpose—CGT; part taxable purpose—depreciation regime) Note however Event K7
Trading stocks: s. 118-25	<ul style="list-style-type: none"> Trading stock subject to trading stock provisions (seek week 9)
Damages for injury: s. 118-37	<ul style="list-style-type: none"> Compensation for personal injury and gambling winnings disregarded

Main Residence Exemption

- A CG or CL is disregarded if the CGT asset was your **dwelling** and it was your **main residence** throughout the ownership period: **s. 118-110** (only have 1 most regularly used, need nominate if >1) (118-B) (define, normal house unit, encourage home ownership)
- Ownership period starts when ownership interest acquired: **s. 118-125**

Dwelling – adjacent land: s. 118-120	As soon as practicable rule: s. 118-135	Absence – 6 year rule
<ul style="list-style-type: none"> Main residence extends to adjacent land if same CGT event happens to it (at the same time: s.118-165). (*also, but have to sell at once (same time)) (adjacent, as a part) Must be used primarily for private or domestic purpose. Maximum area is 2 hectares Designed for farmers. (sell as one single farm, apply for only have house not farm; rules extend and limit exemption) 	<ul style="list-style-type: none"> Deemed main residence (buy property subject to attendance—move out. I move in as soon as practical—can claim main residence) 	<ul style="list-style-type: none"> No other dwelling has been treated as main residence If not rented à can continue to treat dwelling as main residence indefinitely If rented, can only treat dwelling as main residence for a maximum of 6 years. (only 1 main residence, continue to claim even if not, (move to somewhere out) move to rental room; unless rent out for 6 years, if not rent out—forever; can move into and out for longer time)
	<p>Changing main residence (6 mth rule): s. 118-140</p> <ul style="list-style-type: none"> Can treat both dwelling as main residence for a period of 6 months. Must not be renting old house out Old house must be main residence for at least 3 mths in the last 12 mths (only situation to have 2 main residency, when building, overlap, old one is residence, not rent out old) 	

Mandatory exemption: not choice; bad: if sell home at loss—not use—mandatory regardless want or not

Main Residence Exemption—limitations

Spouse: s. 118-170	Partial non-main residence: s. 118-185	Rented part of dwelling: s. 118-190
<ul style="list-style-type: none"> Husband and wife can nominate different dwellings as main residence. If different dwellings nominated, the following rules apply: If your ownership interest < 50%, whole period can be treated as main residence. Note still have to comply with previous rules If ownership interest > 50%, only half the period can be main residence Note spouse includes de facto: Tax a spouse—can one nominate each—but may lose some concession, may 1—full concession; need nominate, husband another 	<ul style="list-style-type: none"> Where dwelling not used as main residence for entire ownership period. However, note extensions discussed previously. CG/CL = CG or CL x non-main residence days / days in ownership period. <p>Proportion daily basis Gain= day claim for exemption/ day in ownership period</p>	<ul style="list-style-type: none"> is used to produce assessable income, the main residence exemption will not apply to that part: Example: if ¼ of the house is rented out, although the house is still your main residence, the exemption will not apply to ¼ of the CG made. (3/4 CG) (proportion. On floor area basis—rest of room)
	<p>e.g. spouse husband wife own home and H 50% wife 50%; wife can claim for MR→\$1 million→500k—full exempt</p> <p>Holiday house H 70% W 30% (H>50%) When sell 70% can claim exempt but 5 year; wife pay 30% because no MR)</p>	

CGT & Death

Main residence of deceased and not used to produce assessable income at date of death	Other CGT assets
<ul style="list-style-type: none"> No CGT consequences for the deceased: s. 128-10 (not CGT event) Beneficiary inherits asset. Cost base = MV on the date of deceased's death: s. 128-15 (just for MR) If beneficiary sold within 2 years of deceased dying, gain or loss disregarded: s. 118-195 Note if deceased used to produce assessable income but acquired before 20/9/1985, 2-year rule still applies: s.118-195 (Not matter if passed 2yr—partial exemption) Partial exemption will apply otherwise as determined above. (just assume not happen, only once beneficiary sell) 	<ul style="list-style-type: none"> No CGT consequences for deceased: s. 128-10 Beneficiary inherits asset. Deceased acquired the asset < 20/9/1985, <ul style="list-style-type: none"> Cost base = MV on date of deceased's death Date of acquisition (for CGT discount = date of death) (discount purpose 50%) Deceased acquired the asset > 19/9/1985, <ul style="list-style-type: none"> cost base = cost base of deceased. Date of acquisition = when deceased acquired it (confined to pre-CGT) (owe to transferred by trustee, admint will owned by passed away)

Rollovers

- Effect is to **defer** the taxing point (pay tax later)

- 2 types:
 - **Replacement asset** Div 124 & Subdiv 112-C (replacing asset/owners—disposal of old)
 - **Same asset** rollovers Div 126 & Subdiv 112-D (changing owners, one asset, marriage breakdown—negotiate settlement; A1 for disposal—rollover)
- Generally, the new asset or new owner picks up the cost base of the **replaced asset or replaced owner**

<p>Scrip for scrip 124-M</p>	<ul style="list-style-type: none"> • Post-CGT shares or trust interests are replaced with other shares or trust interests e.g. company takeover • Conditions: <ul style="list-style-type: none"> ○ single arrangement ○ takeover company must own 80% of original company (one arrangement, get new shares, disposal of old, but just pick up CB) ○ all members must be allowed to participate on the same terms • Rollover: <ul style="list-style-type: none"> ○ Capital gain is disregarded (doesn't apply for capital losses) ○ Cost base of original share apportioned over new share ○ No rollover to the extent of cash received (CASH—pay tax)
<p>Marriage breakdown 126-M</p>	<ul style="list-style-type: none"> • CGT asset transferred to spouse as part of marriage breakdown settlement e.g. divorce • Conditions <ul style="list-style-type: none"> ○ Must be written settlement agreement approved by the Family Court ○ Only relevant CGT events: A1, B1 (Disposals), D1, D2, D3, F1 (Creations) ○ No rollover for trading stock • Rollover: <ul style="list-style-type: none"> ○ Post-CGT asset: transferee picks up transferor's cost base at transfer time ○ Pre- CGT asset: remains a pre-CGT asset for transferee ○ For creations: transferee's cost base is the incidental costs incurred ○ (no assets to transfer, it's rights to transfer)

Step 2—Apply net capital losses from prior years

Net capital loss

- **S. 102-10(1):** (operation section)
 - See method statement
 - Net capital loss is:
 - Total **capital losses**
 - Less **total capital gains** (calculative $TCL - TCG = \text{net loss} \rightarrow \text{carry forward}$)
- **S. 102-10(2):**
 - You **cannot deduct** from your assessable income a **net capital loss** for any income year (CG→CL)
- **S. 102-15(1):**
 - In calculating your net capital gain, net capital losses are applied in the order in which you made them.
- **S. 102-15(3):**
 - If can't apply a net capital loss, it is **carried forward** (indefinite)

Step 3—Reduce by the discount percentage

Discount capital gains

- **Div 115** (CGT discount 50%, regime concession to replace inflation index)
- A capital gain is reduced by the '**discount percentage**' if: (NCG: discount CG 50% or NON-discount CG not 50%)
 - a capital gain remains after applying capital losses and prior year **net capital losses**; and
 - the capital remaining is a 'discount capital gain' (step 1&2 offset losses already→CG→discount)
- no discount for non-residents and temporary residents with respect to capital gains "**accrued**" after 8 May 2012: s. 115-105

Correct entity s. 115-10	<ul style="list-style-type: none"> • Individual - 50% • Trust – 50% (trustee (legal owner)) • Complying super fund – 33 ⅓% • Must not be non-resident or temporary resident: s. 115-105 • (company not discount, no step 3)
Timing s. 115-15	<ul style="list-style-type: none"> • CGT event that happened after 11.45am 21/9/99 (discount introduced)
No indexation s. 115-20	<ul style="list-style-type: none"> • Calculated without indexation (CB, if calculated, recalculate without index) • note special rule for CGT event K7 (depreciable asset)
12 months ownership s. 115-25	<ul style="list-style-type: none"> • CGT asset must have been acquired at least 12 months before the CGT event (12 months + 1 day) • See anti-avoidance rule in s. 115-40 (A1)
Correct CGT event s. 115-25(3)	<ul style="list-style-type: none"> • CGT event must not be excluded (see list) • (D1 not discountable events, list not discounted) • (Apply loss to non-discountable gain: Step2: 600+400 loss 200—offset 200 against 400—full benefit; step3: NCG=1000[600A1+400D1] 600 *50% =300 +400 →700 NCG—step 4

Step 4—Apply the small business concessions

Small business concessions: Div 152

15 year retirement exemption: Subdiv 152-B (best)	<ul style="list-style-type: none"> • Capital gain disregarded if following conditions met: • Basic conditions met; • Owned for 15 years; • Over 55 years and CGT event happens in connection with retirement (or permanently incapacitated); • If it is a share, then the company must have a significant individual (20% interest). (not have superannuation—sell for retire funds, pension; wipe out all CG, complexity tax free, run a business, sell shares of company, not listed, run as family/own company)
50% active asset reduction: Subdiv 152-C	<ul style="list-style-type: none"> • Capital gain is eligible to be reduced by 50 • Only need to satisfy the basic conditions. • (in add to CGT 50% discount, apply for company, which not apply for CGT discount)
Retirement exemption: Subdiv 152-D	<ul style="list-style-type: none"> • Lifetime limit of \$500,000 CG can be disregarded if following conditions met: • Basic conditions met;

	<ul style="list-style-type: none"> • Taxpayer > 55 yrs old. • If < 55yrs old, must pay into complying super fund.
Replacement asset roll-over: Subdiv 152-E	<ul style="list-style-type: none"> • Can choose to disregard CG if basic conditions are met; • Must also acquire replacement active asset 1 year before the CGT event or within 2 years after the event. (sell factory, upgrade old to buy new factory—rollover deferral)

Basic Conditions: s. 152-10

CGT Event	<ul style="list-style-type: none"> • The CGT event must result in a capital gain
If CGT asset is a Share / unit in trust	<ul style="list-style-type: none"> • The taxpayer is a CGT concession stakeholder (i.e. person with 20% interest or spouse of person); or • CGT concessions stakeholders have a small business participation percentage of at least 90% in you (the trustee) • (H&F equal beneficiary → trust → company → carry on business, go up chain 100%*50% of H, H has 100% in trustee → SI, also CGT S/H)
Entity is SBE:	<ul style="list-style-type: none"> • Aggregated turnover < \$2m in previous or current year: s.328-110 (small business entity)
Maximum net asset Value Test: s152-15;	<ul style="list-style-type: none"> • Net asset value of taxpayer and related entities < or = \$6m: s.152-20 • Disregard main residence and assets that are personal use: s152-20 • (if not small business entity)
Active Asset test: s152-35	<ul style="list-style-type: none"> • Asset must be must be active for lower of 50% of the time or 7.5 years (15 years) • Assets are active if used or held ready for use in your business: s.152-40 (and trust) • If asset is a share, then if 80% of the company's asset is active, the share is active: s.152-40 (test company)

Small Business Concessions

- CGT concession stakeholder of a company or trust: s. 152-60
 - Significant individual
 - Spouse of significant individual with a small business participation percentage >0%
- Significant individual: s. 152-55
 - Individual with Small business participation percentage of at least 20%
- Small business participation percentage: s. 152-65
 - Company: percentage of voting power, dividends or capital distributions (interest of company and trust)
 - Trust: percentage of distributions
 - Direct and indirect interests included (100%*50%-indirect, multiple company)
- **Small business entity s328-110**
 - Carry on business; and (not <=, just < less than, less than, rather than equal)
 - Aggregated turnover last year was <\$2m; or
 - Aggregated turnover this year is likely to be <\$2m and 2 previous years was not >\$2m; or (projected at start of income year)
 - Aggregated turnover this year is **<\$2m** (measured at end of income year)
 - (3 tests, satisfy one, better to 3rd → because can use GST continuous throughout year)

Special rules: CGT and foreign residents

- Non-residents **only** subject to CGT if the CGT **asset is taxable Australian property**. (exam—residency)

- Taxable Australian property:
 - Real property; (land)
 - Assets used in a business in Australia;
 - Shares in land rich company provided you hold at least 10% interest (everything else is non tax)
- CGT event I1 deals with **change in residency**. (statute (stop to be resident)—happen for non taxable asset—stop taxing)
- I1 – deemed disposal of CGT assets that are not TAP
 - Can elect **not to have** I1 to happen. However, all **non-TAP** assets **deemed to be TAP**. (will be taxed in the future)
- If individual or company becomes an Australian resident **s. 855-45**: (deem to apply non tax assets)
 - CB/RCB is the asset's market value at the residence change time
 - time of acquisition is residence change time
 - this does **not apply** to taxable Australian property or pre-CGT assets
- There are equivalent rules for a trust.

Case Study

- Joe (Australian resident) purchased a house on 1 July 1997 for \$100,000 (not pre-CGT)
- Joe incurred legal fees of \$1,000 and stamp duty of \$9,000 **on purchase**
- Joe enters into a contract on 1 July 2007 to sell the house to Y for \$200,000
- Settlement occurs on 1 October 2007
- Joe incurs legal fees of \$1,000 on sale (incidental—is not part of CB)
- The house was not Joe's main residence
- Joe has no capital losses or prior year net capital losses (in progress)
- Is Joe liable for CGT on the sale?
- CGT event A1: disposal of CGT asset s. 104-10 (1st CGT event)
 - CGT event A1 happens if you *dispose of a *CGT asset
 - s104-10(2): disposal requires a change of ownership
- CGT asset s108-5
 - The land is 'any kind of property'
- Timing s104-10(3)
 - Entry into **disposal contract** on 1 July 2007
 - Therefore, capital gain included in income year ended 30 June 2008
- **Capital gain/loss?** s104-10(4)
 - Capital gain = Capital Proceeds – Cost Base
 - Capital loss = Reduced Cost Base – Capital Proceeds

Case Study: CB / RCB

- Element 1: X paid \$100,000 to acquire the house
- Element 2: **Incidental costs** of \$1,000 legal fees **and \$9,000 stamp duty** on purchase, \$1,000 **legal fees** on sale (not reduce capital proceeds) (1000—a part of cost base, not as reduce capital proceeds)
- Elements 3-5: n/a
- CB/RCB (without indexation) = \$111,000
- Indexation of CB:

- Yes, acquired before 30/9/1999 & held for 12 months ((1) allowed (2) how)
- Indexation factor = $68.7/66.6 = 1.032$ (income quarter of acquisition date on purchase)
- Element 1: $\$100k \times 1.032 = \$103,200$
- Element 2: $(\$10k \times 1.032) + \$1,000 = \$10,320 + \$1,000$ (1000 incurred on sale, not 1999)
- Indexed CB = $\$114,520$
- No exclusions or modifications apply

Case Study: Net capital gain

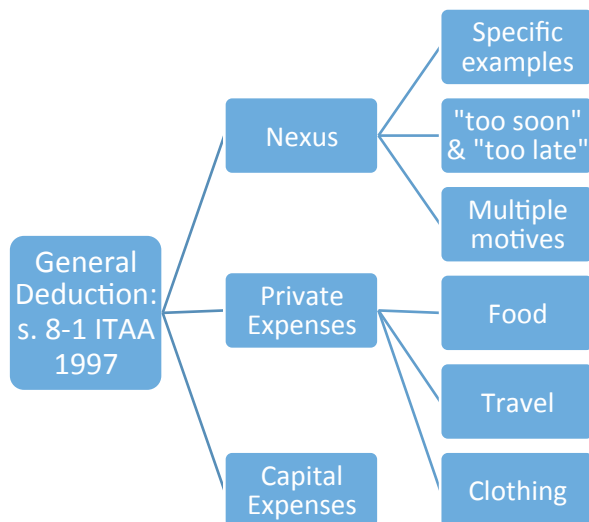
- Capital Proceeds = $\$200,000$
- Capital gain:
 - No indexation: $\$200k - \$111k = \$89k$ (not discount yet)
 - Indexation: $\$200k - \$114,520 = \$85,480$
- No exemption applies
- Discount capital gain
 - Individual; CGT event happened after 21/9/99; No indexation; held for 12 months; CGT event not excluded
 - capital gain reduced by $\$44,500$ ($\$89k \times 50\%$) (AI discountable)
- No small business concession applies
- Net capital gain = **$\$44,500$**

W7—General Deduction Part 1

1. Nexus
2. Private Expenses

Revision and Feedback

- Taxable income = AI – Deduction—general deduction (ordinary operating expense to operate business); specific deduction → x rate
- If a taxpayer's factory—which is covered by insurance—is destroyed by fire, **CGT event C1** occurs. The time of the event is **compensation paid/when loss happen**.
 - **CGT event C2** occurs when an intangible CGT asset expires.
 - Restrictive covenant payments trigger **CGT event D1**.
 - When a share trader sells some shares for a gain, **CGT event A1** occurs. However, the capital gain is most likely reduced to zero pursuant to **section s. 6-5 ITAA 1997**. (CGT not apply, 180-20, anti-overlap rule in ACT, not under CGT, trading shares revenue gain → ordinary operation → revenue account → ordinary income)
 - The most important CGT exemption is for **pre-CGT assets**.
 - If an asset falls into the definitions of both personal use asset and collectible, it is taxed as a **collectible**.
 - Gary bought a boat for $\$20,000$ two years ago for weekend fishing. He sold it for $\$12,000$ this income year. **His capital loss is disregarded**. (personal use asset)
 - Capital loss on collectibles are **only allowed to offset CG for collectible**.
 - Capital gains and losses on an item of collectible are disregarded if the first element of its cost base is not more than **$\$500$** .
 - A small business entity's turnover **threshold** is **$\$2$ million**. (as long as reached, no longer)
 - The four SBE CGT concessions are **(1) 15 years, (2) retirement, (3) 50% active asset, and (4) rollover**.
 - Non-residents are subject to CGT on certain CGT assets known as **taxable Australian property**, being basically (1) **real property in Australia** and (2) **business assets in Australia** (exempt disregarded) (shares and land rich) (big mining company, shares 10%, 50% in Australia???)



Nexus: income and earning & plan to earn & expenditure → only deduction for **income producing activity**

"too soon"—feasible study. Too early, not carry on business (or may under CGT cost base)

Multiple motives—private business, a proportion to extend for private purpose → part deduction

Private expense—not deductible (holiday, exceptions, childcare)

General deduction = ordinary income, broad topic

Capital expense → capital outlay large, big business, depreciate overtime, not 8-1 deduction, that is capital deduction/expenditure

s. 8-1 ITAA 1997

You can deduct... any (1) **loss or outgoing** to (2) **the extent** that: (2: proportion)

- (a) It is (3) **incurred** in (4) **gaining** or producing your assessable income; or (3: not hypothetical, not fully subjective)
 - (b) It is (5) **necessarily** incurred in carrying on a *business for the purpose of gaining or producing your assessable income... (5: not = it is necessary incidental to business, appropriate in that circumstance to incur that expense)
- (Method: positive **limb** 1 at least, and fail all 4 negative **limb**)

However, you cannot deduct a loss or outgoing under this section to the extent that:

- (a) It is ... of a capital nature; or
- (b) It is ... of a private or domestic nature; or
- (c) It is incurred in relation to gaining or producing your *exempt income or your *non-assessable non-exempt income; or
- (d) A provision of this Act prevents you from deducting it. (Div. 26)

Nexus:

Total Holding

Fact: (need sufficient nexus)

- Investment Company received interest bearing loans from parent company
- **On-lent** to its subsidiary, some of which were **interest free**
- Issue: interest expenses attributable to interest-free loan deductible?

Held: **deductible**

Reasons:

- “If a taxpayer incurs a *recurrent liability of interest for the purpose of furthering his **present or prospective income-producing activities***...generally the payment...will be an allowable **deduction**”
- Loans are “designed to render [the subsidiary] profitable as soon as commercially feasible” and thus **generate** A.I. for the taxpayer.

Tax payments

Income tax payments: deductible under **s. 8-1 ITAA 1997**?—not deductible

- Arguably “necessarily incurred in carrying on a business”. (loss or outgoing?)
- But **not for “producing A.I.”** (elements test) (by paying tax, tax is not required to pay to generate income—**lack of nexus**)

Cf.

- GST: specifically **disallowed**: Division 27 ITAA 1997
- Stamp duty, land taxes, etc.: **deductible** under s. 8-1 (they are not tax under this ACT)

Theft loss—Theft loss of business proceeds?

Deductible: Charles Moore

Reason: “**Banking the takings is a necessary part** of the operations that are directed to the gaining or producing day by day...assessable income”. (not incurred in generating income; **broadly** “in” the course of producing assessable income→banking and taking is ordinary activity→part of making income)

Specific deduction: theft loss by employee: **s. 25-45 ITAA 1997** (specific)

Expenses on Wrongdoing

Penalties and fines?

- “Penalty is imposed as a punishment of the offender considered as a responsible person owing obedience to the law. Its nature severs it from the expenses of trading”: **Herald & Weekly Times**
- In general, penalties payable under an Australian law or a foreign law: **not deductible: s. 26-5(1) ITAA 1997** (speeding fines, loss→fine itself incurred, obliged to pay, in carrying in business→not of business activity, not involve speeding, are you doing anything to further business, grey area, truck driver; racing from client to client, deformation colligation; punish about punishing wrong doer, not assessable income)
- Cf. **legal expenses** re defending against charges: can be **deductible** provided **sufficient nexus**:
 - Expenses to protect company’s ability to carry on business→sufficient nexus: **Magna Alloys** (deductible→payment to lawyer) (deny for penalty)
 - Legal expense in defending disciplinary charges brought against an individual by his employer: **Day** [2008] HCA 53.

Theft loss of illegal proceeds?

- **Deductible**, provided **sufficient nexus** to the illegal activities which produce A.I.: **La Rosa** (Drug carry on business (**Moore** case) tax law not to punish wrong doing but s. 26-54)
- Now: **not deductible** if incurred for offences punishable by imprisonment ≥ 1 year: **s. 26-54 ITAA 1997**
 - Commissioner can amend assessment **within 4 years** of conviction of the offence (standard amendment time, prevent from paying tax 4 years ago)
- Also excluded from **cost base** and **reduced cost base: s. 110-38 & 110-55(9A) ITAA 1997**. (not in CB, not deductible)

Nexus—too soon

Maddalena (1971)

Fact: professional footballer incurred travel and legal expenses in negotiation for transfer of employment to another club.

Held: **not deductible**

Reasons:

“The expenditure would have been incurred in **getting, not in doing, work as an employee**. It would come at a point too soon to be properly regarded as incurred in gaining assessable income”. (to get a job, not in doing a job, not producing any AI yet) (not have to get income **Walkers** case→**deductible**→intentional to produce AI→if not actually, not money, not matter)

Cf. agency fees of professional **footballer to negotiate contracts: deductible: Spriggs v FCT; Riddell v FCT** [2009] HCA 22. (Common practice, ordinary industry practice)

Spriggs v FCT; Riddell v FCT [2009] HCA 22

- Employment vs professional sportsperson/business
- In **business**? (all other activities→business; in employment or own business?) (**Stones**)
 - A question of fact
 - High Court: **yes**
 - Not simply an employee of his club
 - Exploited their sporting prowess and associated celebrity with different clubs over the years
 - Synergy between playing activities and non-playing activities: both income-producing activities (business slope and activity, size/slope/time/frequent)
- Capital expenditure?
 - No: contracts were revenue assets of short term nature. (expenditure→deductible)

Steele

Fact:

- Taxpayer acquired a property, intending to build and operate a **motel** on it
- In the meantime, derived small income from property
- Due to dispute with her business partner, sold her interest in property
- Claimed **interest expenses** for past 6 years on loans used to purchase property

Held: **deductible** (deductible even though not make money)

Reasons:

- “**Temporal relationship** between the incurring of an outgoing and the actual or projected receipt of income...is **not legally essential**, and whether it is factually important may **depend upon the circumstances of the particular case**” (point: committee the project expense→deductible)
- Now: may subject to **non-commercial loss rules: Div 35 ITAA 1997**. (stop claim deduction for hobbies, not produce any AI)

Nexus—too late

Temporal Nexus

- **Not necessary** for expenses to be incurred “in a year when the company is **actively on that business**”: *AGC (Advance)*
 - Principle followed in **Placer Pacific Management**

- Established “**long tail liabilities**” principle (not matching principle, claim when incurred, deductible to the year subject to that, **incurred**) (**solely connected** with business, but ceased→but still deductible)
- Same principle applied to interest expenses on loans acquired during active business period, even if the interest were incurred after the **business ceased**: **Brown, Jones** (change plan to the business activity, connected)

Multiple motives

“To the Extent”—**Fletcher**

Fact:

- Taxpayer entered into tax minimisation scheme
- Purchased an annuity from related company, financed by loan from Group Company.
- Would result in large losses in **first few years**.
- Option for taxpayer to **collapse arrangement**.

Held: **deduction limited** to the **amount of A.I. from annuity**. (up to income retained)

Reasons:

- “**Motive** of the taxpayer in making the outing...a **possible relevant factor to consider**”
- If A.I. > expenses, prima facie deductible (motive not matter)
- If A.I. < expenses, requires inquiry into the **motive** of taxpayer
 - Apportion if have motive other than **producing A.I.** (use proportion, URE case: borrow loan from bank at interest rate of 12.5%, and make loans to his wife, and wife pays 2% interest—purpose basis→purpose of spending 12.5% → benefit wife→2% deductible; 10.5% not deductible→private expense)

Payments to Related Entities

- **Deduction limited** to amounts deemed **reasonable** by the Commissioner: **s. 26-35 ITAA 1997**
 - Symmetric treatment for recipient: s. 26-35 (4) ITAA 1997 (Limited to normal market value) (somebody else, level of expertise)
- Related entities:
 - Include “relatives” as defined in s. 995-1 ITAA 1997 (husband and wife, overpay relative→ bigger deduction→less tax)

Expenses for Capital Gains

If expenses would otherwise be deductible solely due to “an amount...included in the assessable income... [as] net capital gain”: **not deductible**: **s. 51AAA ITAA 1936**. (Denying deduction when only income) (Not 8-1→not AI for income ordinary income) (Property, real estate)

What if revenue expenses are incurred for **both O.I.** and **capital gain** (e.g. interest expenses on investment properties)? (proportion out→2 motivations) (buy asset solely for negative capital gains (NCG), not part of ordinary business→not 8-1→for incurring AI) (Significant wage→buy property)

Negative Gearing

s. 51AAA: applicable?

- Possible, but need to **apportion the expenses** to current rental income and **future anticipated capital gain**→how? (change/ market value)
- ATO practice:

- Due to absence of a specific apportionment formula, **interest expenses fully deductible** (deductible even for CG)
(Deduction off other gain pay tax ← negative gearing deduction/expense on property, depreciation and interest deduction → income rent get from)
- **Very preferential treatment**
 - Timing: current deduction vs capital gain in future (CG → future → difficult, not know CG component, not on market value increase)
 - Amount: full deduction vs CGT discount
 - Cf. “passive activity losses” rule in the US (guarantee negative gearing losses, not negative gearing offset)

Individuals: Net Rental Income

	Number ('000)	%	\$(billion)
Net Profits	528	31%	4.1
Net loss	1198	69%	(12.7)
Total	1726		(8.6)

Rental → for negative gearing

Private Expenses

Food

- Incurred “for” vs incurred “in” (not for)
- **Nexus too remote**: e.g. **Cooper** (footballer, eat a lot to be strong, what is the course/activity for producing A.I. → not paid for bear, paid for play) (not sufficient nexus) (private, different: provide food to somebody else)
 - Has to “eat” even if not producing A.I.

Travelling Expenses

- Travel during leave to improve professional knowledge and skill: deductible: **Finn** (deductible, conference architecture, represent firm → related to work)
- Travel between **home and alternative workplace** (e.g. client office): deductible: **Ballesty** (grey (private in nature) → rugby player training place gym → get deduction → nothing privately excessive nature → home as base for different places → unique case ***facts)
- Travel between workplaces: specific deduction: **s. 25-100 ITAA 1997**
- Travel expenses between home and workplace (e.g. employer’s office)
 - In general, private expenses: **Lunney; Payne** (2 places, unrelated jobs → not deductible) (Home → work: not undertaking work when travel → not earn salary → private expense)
(Travel from work 1 to 2 → get deduction → not private, deduction even though 8-1 → if home office not use 25 → not live in either of them) (e.g. client 1 and client 2 → is same job, not different job, 25 only different job, primer → deductible because he is working → producing A.I. for traveling)
 - Exceptions

Travel Between home and work

Exceptions to general rule:

- Carry bulky tools or equipment for work and could not leave at work
 - e.g. extension ladder or cello: **Vogt** (transport → get deduction)
- Home: a base of employment (could be deduction, latter points)
 - Start work at home and travel to a workplace to **continue** the work

- e.g. IT staff: **Collings**
- Shifting places of employment
 - Regularly worked at more than one site each day before returning home (primer deduction)
 - e.g. travelling salespeople, teacher teaching at 4 schools per day: **Wiener**

Education Expenses

Sufficient nexus? (not always)

- Education expenses incurred to **enable taxpayer** to be transferred to a **higher salary scale**: deductible: **Hatchett** (direct increase pay scale, automatically for HSC, also arts degree → not deductible → not sufficient nexus → general skill, not teaching skill)
- Subject to **s. 82A ITAA 1936**
- Self-education expense: **first \$250 not deductible**
- ATO position:
 - “a relevant connection to taxpayer’s income-earning activities” → deductible: **TR 98/9**

Home Office

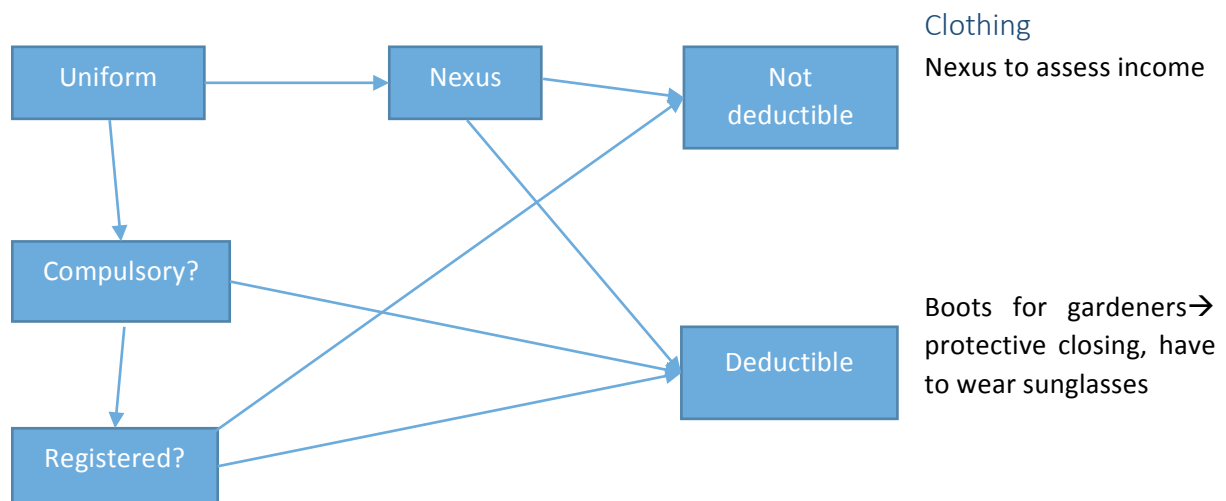
- Running expenses:
 - e.g. electricity and cleaning expenses attributable to the home office
 - **Deductible: Handley**
- Occupancy expenses:
 - e.g. mortgage interest, rates and insurances (proportional deduction) (occupancy expenses)
 - If genuine “place of business”: deductible: **TR 93/30** (two types: real and not real)
 - <http://law.ato.gov.au/atolaw/DownloadNoticePDF.htm?DocId=TXR%2FTR9330%2FNAT%2FATO%2F00001&filename=pdf/pbr/tr1993-030c1.pdf&PiT=99991231235958>
 - Issue: CGT exemption for home
 - Otherwise: **not deductible: Handley**
 - (author → no other place, barrister: purpose for study is for convenience, not deductible → but not mortgage, operating expense cleaning/light/printing expense deductible)

Entertainment

- **Circular definition: s. 32-10 ITAA 1997**
 - **Entertainment** means: (a) entertainment by **ways of food, drink** or *recreation; or (b) accommodation or travel to do with providing entertainment by way of food, drink or *recreation. (food, drink and party → deductible)
- Specific provisions in **Division 32**:
 - In general, **not deductible** unless one of the **exceptions: s. 32-5**
 - Exceptions: e.g. (to employee to certain situation)
 - Fringe benefit: **s. 32-20** (are deductible under 8-1 table; 8-1 deductible? Yes → Div 32 deny desk → exception to deny → get deduction)
 - Certain promotion and advertising expenses: **s. 32-45**
 - Etc.

Medical Expenses

- In general, personal expenses, unless attributable to employment/business (not deductible)
- Specific **tax offset**: “medical expense tax offset” (tax offset is not deduction right to end after tax rate)



- General rules apply: (not deductible)
 - e.g. winter coat for workers in freezer room: deductible (protective clothing, harsh condition) (deduction for those dress **over and above normal person need**)
- Examples:
 - **Edward**: extra clothes for personal secretary of Governor's wife (outfit, not wear same in the same day, condition of employments)
 - **Mansfield**: extra-large shoes & moisturiser for flight attendant (Qantas, because of work, need to buy compression stocking → over and above normal person need → solely for harsh condition)
 - **Morris**: sunscreen lotion & sunglasses for tennis umpire
 - Funeral director in tropical Queensland:
 - Black suit? (sufficiently connected? Not specific enough; not connect with employer → privatised) (suits not deductible, not registered, connection not sufficient with employer)
 - Black trousers?
- Specific rules for “**non-compulsory uniform**”:
 - In general apply for employees: **s. 34-5** (Normal not deductible, unless design/protective).
 - Not deductible unless either occupation specific clothing, protective clothing or properly registered: **s. 34-10**.
 - **TR 97/12 & TR 2003/16**:
 - <http://law.ato.gov.au/atolaw/DownloadNoticePDF.htm?DocId=TXR%2FTR9712%2FNAT%2FATO%2F00001&filename=pdf/pbr/tr1997-012c3.pdf&PiT=99991231235958;> & <http://law.ato.gov.au/pdf/pbr/tr2003-016.pdf>
(chief → deductible → **identify** you with the employer, **not wear out**, judges)

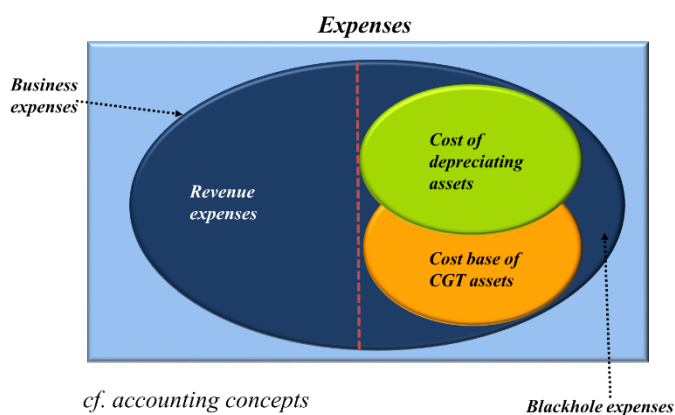
W8—General Deduction—Part 2

1. Capital Expenses
2. Case study: Citylink
(nexus, personal in nature, capital broadly, AI, NANEI)

Revision + Feedback

- The rules for general deductions are stipulated in **section s. 8-1** of ITAA **1997**.

- An expense is in general deductible under the general deduction provision if it is incurred in the production of **AI (assessable income)**.
- The four negative limbs in the general deduction provisions are **(1) private; (2) capital in nature; (3) NANEI or EI and (4) prevent by provision**
- The words **to the extent** in the general deduction provision dictates apportionment of expenses.
- The issue of “an expense incurred too soon” in general depends on whether there is sufficient **nexus** between the expense and the production of **AI**.
- Food expenses are in general not deductible because they are **private** in nature. (grey, insufficient nexus)
- Travelling expenses between home and office are in general **not deductible**, subject to **4 exceptions**. (deductible)
- Running expenses (such as **electricity**) of a home office are **deductible** while occupancy expenses (such as **mortgage interest**) are **not deductible** unless the home office is a genuine **home office**.
- Clothing expenses are in general **not deductible** because they are **private in nature**, unless they have the sufficient **nexus** with the production of **AI**, or are uniforms that are **compulsory** or **registered/protective**.



Deductions—General Concepts

Capital expenses

Ongoing, regular basis

Not either of them

Capital Expenses

- *If has nexus with A.I., why not deductible?* (Capital expenses, business premises)
 - Historical: “**capital gains not taxable**→capital expenses not deductible”
- Blackhole expenditures: (e.g. feasibility study/research, not go on project, no asset, not income base) (intention to AI, but not go on, not feasible) (taxing)
 - Mostly resolved by **s. 40-880 ITAA 1997** (yes, deductible) (upfront deduction) (expense too large, wrap out all AI, not appropriate reflection, the benefit gets from capital expenses)

s. 40-880 ITAA 1997

Long overdue: (s. 8-1 first not deductible because capital in nature→s. 40-880)

- Blackhole expenses: **Capital expenditure** are in general disallowed (because capital in nature)
- 1999: Ralph Report: suggested “tax value method”
- 2001: s. 40-880 (old version): only for 7 specific items
- 2006: final legislation
- Business related costs: **s. 40-880 ITAA 1997** (that capital in nature)

- **5 year straight line** amortisation (20% each year)
- Conditions:
 - **Capital expenditure** (capital in nature)
 - “in relation to” **existing, past or future business** (proposing to carry on, at moment wound up)
 - For “taxable purpose” (relation to business)
 - **Not recognised elsewhere***** (e.g. in cost base of CGT asset) (if do have asset, capital in nature, CB→not s. 40-880→come after CGT)
 - Not specifically disallowed (old—deny)
 - Not return of capital or debt (finance, loan)
- ATO position: TR 2011/6

<http://law.ato.gov.au/atolaw/DownloadNoticePDF.htm?DocId=TXR%2FTR20116%2FNAT%2FAT0%2F00001&filename=pdf/pbr/tr2011-006c1.pdf&PiT=99991231235958>

- Examples of “business-related costs”
 - Expenditure to establish/change business structures (Partners→trust→company, legal fees, protestation)
 - Expenditure to **raise capital** for a business (issue shares/instruments)
 - Expenditure of feasibility study that **does not lead to an actual project** (other project: s. 40-830)

Capital vs Revenue Expenses

- “In many cases it is almost true to say that **a spin of the coin** would decide the matter almost as satisfactorily as an attempt to **find reasons**”: *IRC v British Salmson Aero Engines Ltd.* (1938) 2 KB 482 (distinction for deduction) (paying for time (amount pay reference to time)→revenue in nature→no long lasting durable amount) (reasons: diverse, not consistent→identify the principles)
- Tests:
 - **Once and for all test**: (pay once for all→lump sum→capital in nature→not conclusive, register company up front cost→forever, not in **reference to time**)
 - But one **lump sum payment** could be **revenue** expenses: **National Australian Bank (1997)** (pay defence loans, employee cheap loans, loan subsidised, capital or **revenue in nature**→marketing expenditure, lump sum not change **nature**, not change business structure, still **revenue in nature**)
 - **Enduring benefit** test (long lasting benefit, regardless of how long, may cause **time** consideration sometimes)
 - **Structure v process** test
 - Leading case: Sun Newspaper

Sun Newspaper

Fact:

- Newspaper publisher purchased all rights of competitor’s newspaper, and right to use its publishing equipment for 3 years (in instalment, preserve business structure, restrictive covenant, monopoly)
- Competitor also agree not to publish other newspaper for 3 years
- Whole price was tied to use of equipment and covenant
- Taxpayer then ceased publication of the paper

Held: **Capital Expense**

- Reasons: payment was for “**strengthening and preserving the *business organisation*...**the profit-yielding subject, and affecting the capital structure” (protect market share, not extending/expanding, just protection)

CGT implications? (Leading test for what is capital, **3 part tests***** (1) characteristic of advantage sought→something long lasting; (2) what is the manner (how to use the benefit→on going or time) (3) main detain advantage→lump sum or along time))

- CGT asset? (no, create right others cannot publish newspaper)
- Cost base?
- When is it deducted?
- Capital gain/loss? (on expiry, but it is not the whole right) (economic position at moment, true reflection of income)
- Time of event? (C2, 3 years)

Broken Hill Theatres

Fact:

- Taxpayer operated cinemas in Broken Hill (want to run movies in the town hall, propose APP)
- Incurred legal expenses to oppose opening of competitor’s cinema (monopoly, market share)
- Taxpayer had incurred similar expenses several times, and might incur them again in future.

Held: **Capital expense**

- Reasons: “incurred...for the purpose of **preserving and protecting the company’s business**”
 - I.e. “**structure/process**” test ((1) characteristic (2) manner (3) enjoyed, incurred once for all)
 - Even though the protection from competition might only last for 1 year
- CGT implications? (rule out APP, not protect from now, new competition will come to market)
- Any new CGT asset acquired? (market share, not CGT asset, not increase in real estate value)
- Add to cost base of existing cinemas?
- Timing of recognition? (if C2→deduct at end, not over life, when enjoy benefit)
 - **S. 40-880 ITAA 1997** (5 year amortisation, deduction of expenses)
- Cf. accounting treatment?

BP Australia

Fact:

- Lump sum payments to service stations for **exclusive sale of its products** for a number of years (typically 5 years) (industry change overtime, common place today, not common place before) (become common place, exclusive sales)

Held: **revenue expenses**

Reasons:

- “The case is not easy to decide. But on ***a balance of all the relevant considerations*** the scales appear to incline in favour of the expenditure ***being revenue not capital outgoings***” (not s. 40-880 then, revenue expenditure→whole deduction up front, but prefer amortise)
- Judges conceded that the “***most apt way of dealing with*** these sums” might ***be amortised over*** the term of the agreement
 - But tax law did not provide for this treatment.

Regent Oil

- Similar fact as BP Australia, except
 - Agreement in the form of “lease premium arrangement” for 10-21 years (sub lease)
 - In return for a lump sum “lease premium”

Held: **capital expense**

- Reason:
 - Again, the court was forced to choose **either capital or revenue treatment, without the option to amortise** (lump sum → acquire lease agreement → capital asset → capital in nature) (different from BP)
 - The 2 cases were decided consequently by the same judges
- CGT asset? (lease, several leases)
- Cost base? (yes, as asset → lease include premium amount/not entire)
- Time of recognition? (**F1** → lease premium granted, bring whole amount **up front** → **at end/ up front/ amortise**)
- cf. accounting treatment?
- CGT implications for lessor?
 - **CGT event F1**

Purchase Price of Capital Assets

- In general, **capital expense**
Variations in form:
- Rental payments (revenue in nature)
- Lump sum plus periodical payments (not stop testing capital, because over time)
- Periodic payments based on income from asset (percentage of where income generated)
- Periodic payments: part of purchase price?

Cliffs International (1979):

Fact:

- Taxpayer purchased shares in a mining company
Consideration:
 - **Lump sum** plus “**deferred payment**” of 15 cents per ton of iron ore extracted (if any), and
 - Royalties from consortium which mined the ore

Held: **revenue expense** (3:2 decision) (not acquire actual asset → the deferred is iron ore)

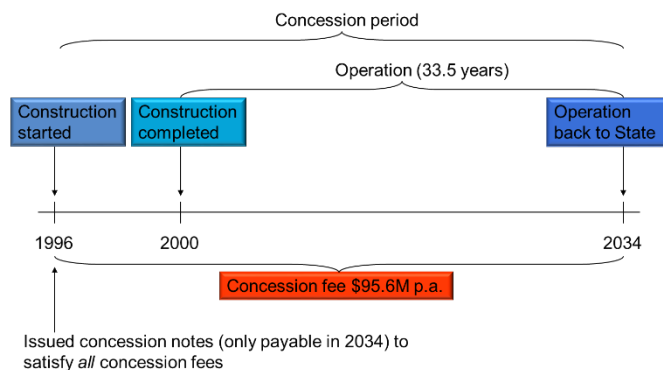
Colonial Mutual Life Assurance Society Ltd (1953):

- Fact:
 - Taxpayer purchased land
 - Consideration: 90% of rents from shops on the land for 50 years
 - Charge on the land as security for payments
- Held: **capital expense**
 - “The money are paid **in order to acquire a capital asset**”
 - **Recurring expenses: not always revenue in nature** (all for acquisition of asset, not for anything else)
- Cf. Cliffs International
- **What about the recipient? Taxable on the payments?**
 - Yes: Just (nature/capacity not have to match)

Case Analysis: **Citylink Melbourne Ltd** [2006] HCA 35

Income tax issues:

- Historical cost basis (tender processes)
- No concept of PV/time value of money



- Opportunity of timing **manipulation** (amount of deduction)

Whole section of document to form a big contract

Design construct and maintain over concession period

Concession fee: each year, right to use road → pay semi-annually; but never paid any money actually, issue concession notes

Before 1996: I owe you notes issued to state, unless road revenue, if cost of project < road revenue — not payment until 2034.

Discharged liability to pay concession fee by another liability → not payable until 2034

Additional facts:

- \$3b project (largest urban infrastructure project in Australia) (not interest bearing)
- Concession fees: payable semi-annually
- Concession notes: **non-interest bearing**
- Any amount owing to the State: not due for payment until **sufficient fund** in Distributions Account to meet the **payment in full** (profit after all expenses)
 - i.e. surplus cash after meeting all expenses
 - effective deferral of payments
- Present value of concession notes in question (for years 1996 to 1998): close to nil (PV of it)

Issues:

- “Incurred”?
- Capital expense?
- Shares of profits instead of “expense”? (split collection)
- ATO v Citylink arguments? (ATO: not incurred → still constructing, not intention to construct, absolute intention concession was contingent reach target, future expenses — meet future revenue/deduction in future time → referable in future when payment due → proportion → capital in nature) (Citylink: produce against AI, referable to current year, concession fee, not get asset, no any actual asset, no enduring asset)

ATO missed opportunities

- Present value (next to nothing)
 - **Carden’s** case: “correct reflex of true income” (correct reflection of income position)
 - First instance para 87 & 150
 - Full Federal Court para 36
 - HC: refused leave to amend grounds of appeal
- Part IVA (anti avoidance provision, obtain tax benefit, PV of concession notes → not → miss appropriate make sense)

- First instance para 145
- cf. HC judges' perception: para 99 & 121
- Capital expenses: concession fees for construction period: (right on the land—profit yielding) (upfront period)
 - Full Federal Court para 65

Decisions:

- First Instance:
 - Two arguments:
 - Capital expenses: blackhole expenditure
 - **Now: 5-year amortisation: s.40-880 ITAA1997**
 - “share of profits”: weak argument
- Full Federal Court: fully deductible
- High Court: 5:1 majority (upfront in each expense year → time of discharge of liability)
 - “incurred?": Judges bounded by **precedents (except Kirby)** (not incurred until paid, no deduction, all wordings on discharge → timing of liability → still have to pay, but time is now pushed down.) (not about discharge)
- Anomaly
 - “such an outcome might be seen to be something that might only be expected in a **taxpayers' heaven**” (massive losses, just play on time value of money)
- Now: **TOFA** (big taxpayer, gain/loss over time period (concession) → accrued referable every year)

Year	0	1	2	3	4	5	6	7	...	37
Interest (\$M)	-	0.28	0.31	0.34	0.37	0.41	0.45	0.5	...	8.69
PV + Interest (\$M)	2.8	3.1	3.4	3.7	4.1	4.5	5	5.5	...	95.6

Assumption: Discount rate = 10%; **Amortise** based on PV, rather than upfront or at end.

(Issues decided by the High Court:

The question for the Court was whether the concession fees claimed were allowable deductions under subsection 51(1) of the Income Tax Assessment Act 1936 (years ended 30 June 1996 and 1997) and section 8-1 of the Income Tax Assessment Act 1997 (year ended 30 June 1998). In this regard there were two issues that had to be decided by the Court:

1. Whether, the amounts in question were outgoings incurred in, and properly referable to, the income year in respect of which they accrued payable; and
2. Whether the concession fees were outgoings of a capital nature.

Answer to the first issue

- The majority of the High Court (Gleson CJ; Gummow, Callinan and Heydon JJ adopting the written judgment of Crennan J) held:
- The concession fees were incurred in the relevant year of income because Transurban was under a contractual liability to make the payments in the relevant year;
- There was a contractual liability to pay the concession fees irrespective of the subordination of the State's right to payment or the concession note mechanism for discharging the liability;
- Conditions affecting the timing of discharge (but not the creation of the liability) does not render the liability contingent;

- Transurban was definitely committed and had completely subjected itself to the outgoings which the concession fees represent;
- The concession fees were, like any periodic licence fee, payable for its period. The outgoings did not secure rights in future years and were referable to the income years in question.

Answer to the second issue:

- The majority in agreeing with the reasons of Justice Crennan held that the concession fees were of a revenue nature. The concession fees were characterised as periodic licence fees in respect of the City Link infrastructure assets that ultimately must be surrendered to the State in contrast to periodic instalments of the purchase price of a capital asset.

Implications of the decision:

- The result of this case flows from the disposition of the majority to view the concession as a licensing arrangement and the concession fees as periodic licence fees.
- The decision entrenches a jurisprudential approach for the determination of when an outgoing is incurred for the purposes of the general deduction provisions. In this regard it places importance on a legal analysis of the arrangements to distinguish between conditions that concern the creation of liability and conditions that merely affect discharge.
- Other than distinguishing the situation in Coles Myer Finance, the decision does not shed any further light on the properly referable principle as previously articulated and applied by the High Court.
- As the majority view amounted to an application of existing principles governing the deductibility of losses and outgoings under the general deduction provisions, it is not proposed to amend current Tax Office Rulings (most relevantly TR 94/26 and TR 97/7 dealing with the meaning of incurred and the application of the properly referable principle) or issue further interpretative advice dealing with the decision.)

W9—Specific Deductions

1. Specific Deductions (AI—Deduction = TI; Deduction—General: 8-1, specific: others)
2. Capital Allowance
3. Special Capital Allowance Regimes
4. Capital Works Deductions

Revision + Feedback

- The three tests for capital expenses are (1) _____; (2) _____ and (3) _____.
- The provision of last resort to deal with blackhole expenses is section **s. 40-880 ITAA 1997**. That section allows amortisation of eligible capital expenses over **5** years.
- A company incurred \$300,000 for a feasibility study investigating a proposal to establish a subsidiary in China. In the end, the company decided not to go ahead with the proposal. What should be the tax treatment of this amount? (feasibility study → decide whether to start → **not 8-1** committed to business; Blackhole expense—can **deduct capital expense**, supposed to carry on, **amortise for 5 years**, not lump sum)
- A lump sum payment made by a company to purchase a capital asset is likely to be **capital** in nature. However, the nature may be different if the payment is made on a **periodic/recurrent** basis.

- The regular payments to purchase capital assets in **Cliffs International** case were held to be **revenue** in nature. (iron ore, 3rd payment calculate per tone of ore)
- In contrast, similar payments in Colonial Mutual Life case were held to be **capital in nature**. This is despite the fact that the recipient of those payments were taxable upon **ordinary income base**. (just)

Specific Deductions

- Definition: **s. 8-5 (3) ITAA 1997**
- Deductions **specifically**:
 - Allowed: **s. 8-5(1)** (not cite, use actual section)
 - Denied/limited: **s. 8-5(2)**

Section 25-5	•Tax-related expenses
Section 25-10	•Repairs
Section 25-20	•Lease document expenses
Sections 25-25	•Borrowing expenses
Section 25-35	•Bad debts
Section 25-45	•Loss by theft etc
Section 25-55	•Payments to associations
Division 40	•Uniform capital allowance & Div 328 (SBE)
Division 43	•Capital works deduction

Deductions Specifically Allowed

- **Division 25 ITAA 1997**: general deduction rules may still apply (specific deduction 25, not mean not deductible under 8-1→25 not as good as 8-1) (subscription of membership→8-1 better→specific: up to 42, anti-overlap, only one→6-25 most appropriate)

Tax-related expenses: “managing your tax affairs”: **s. 25-5 ITAA 1997**

- Definition of “tax affairs”: **s. 995-1(1)**
 - “Tax affairs means affairs relating to *tax” (defined term)
- No deduction for: (exclusion)
 - Advice fees **unless** advice provided by “**recognised tax adviser**”: **s. 25-5(2)(e)**
 - Tax agents/lawyers (must be who are paying) (accountant tax return fee→deductible)

Bad debts: deductible if: **s. 25-35 ITAA 1997**

- Bad debt written off **in the income year**, and (owe money, not pay, written off)
- Amount included in A.I. or in respect of money lent in money-lending business (if lend money→ordinary business to market at large, **revenue basis**, ordinary business expenditure/ not get paid, liquid creditor arrangement get less debt—must be **existing debt**, but **need to make effort to contact** debtor) (actually get debt)
(Not just a deduction for all debts not received yet, to averse accrual, accrual basis not cash basis, accrual income →included in A.I. →not get anymore→ reverse)

Repairs: **s. 25-10 ITAA 1997**

- You can deduct expenditure incurred to repair premises or a depreciating asset if:
 - Asset used to produce **assessable income** (rental property)
 - **Expenditure not capital**
- Capital expenditure: (not deduction under 25-10)

- Replacements
- Improvements
- Initial repairs
- **Notional** expenses **not** deductible (**not actually spend** money, **irrelevant**—only look at money **does spend**)

Replacement of a whole asset: *Lindsay v FCT*

- Ship repairing business (ship marina, build a new one, longer)
- L **demolished 1 of its slipways** and replaced it
- L argued slipway was part of its business premises or part of the hauling machinery
- Question: whether it is capital expenditure?

Held: **not a repair** (the marina → capital, not deductible under 25-10)

- **Slipway was an entire asset**
- Renewal in this case was '**reconstruction**' of the entirety (demolish and replace, *fixed up to back to original position*)

"Repair" vs "improvement"

- A question of fact and degree: *Lindsay*
- Work done to restore an asset to its **original state** → "repair"
- Work done to improve the asset **over its original state** → "**improvement**" → capital expenditure

Improvements: *BP Oil Refinery*

- BP ran oil refinery
- Refinery was supported by **wooden pylons** which were being eroded
- BP covered them with concrete to prevent further damage
- The concrete did not have any effect on the previous damage

Held: **improvement, not a repair**

- The **concrete improved** the **ability** of the pylons to **withstand further damage** (not the original damage) (claim as repair, **but beyond original position**, last longer)

Improvements: *Western Suburbs Cinemas*

- Cinema replaced the ceiling
- Architect decided it was impractical to repair the ceiling with the same materials because **far superior materials were now available** (use more expensive one)

Held: **improvement, not a repair**

- The work did much more than meet a need for restoration; it provided a ceiling having considerable advantages over the old one (grey area: roof as its own, not as whole, notional expense concept: expensive and cheap materials, choose the expensive, would have deduction if choose cheap ones → not expense any money on cheap material → only look at money spend → cannot deduct the cheap amount)

Initial Repair: *W. Thomas & Co.*

Fact:

- taxpayer just bought a building
- performed repair work to building before it could be ready for use

Held: **capital expenditure**

Reasons:

- “Expenditure upon repairs is properly **attributed to revenue account** when the repairs are for the **maintenance** of an income producing capital asset ... But if when a thing is bought for use as a capital asset ... it is not in good order ... ***the cost of putting it in order suitable for use is part of the cost of its acquisition***, not a cost of its maintenance” (buy income producing asset, only look at repair, not acquisition cost—put in good order)

Initial Repairs: **Law Shipping Co Ltd v IRC (1923)**

- Taxpayer acquired a ship which required a repair
- Undertook 1 voyage, then repaired it

Held: **capital expenditure, not a repair**

- The cost of this ‘initial repair’ formed **part of the acquisition costs**, therefore was capital (Initial repair to bring ship in working condition to produce A.I.)
- **Taxpayer would have paid a lower price for the ship due to the need for repair*****
- Expenditure was necessary at the time of purchase to render the ship serviceable

Initial Repairs: **Taxation Ruling TR 97/23**

- An asset will be an entirety if an asset if it: (summarise case laws)
 - Is separately identifiable as capital equipment
 - Provides a function on its own
 - Is a distinct item of plant, or
 - Is a ‘unit of property’ as per the depreciation rules
- Initial repairs are capital and **not deductible** if the defect:
 - Existed at the time of purchase
 - Did not arise from the operations of the person who incurs the expenditure

Notional Repair: **Western Suburbs Cinemas**

- Fact:
- taxpayer tried to deduct notional repair cost of ceiling of cinema, which was replaced with new ceiling

Held: **not deductible**

Reason:

- “when a taxpayer has two courses open to him, one involving an expenditure which will be an allowable deduction ... and the other ... not ... an allowable deduction, and for his own reasons he chooses the second course, **he cannot have his income tax assessed as if he had exercised his choice in the opposite way**” (cannot pretend do on original material) (demolished→not improvement →restore something there, not get rid of→ still get existing→ difference between improved material and non-improved material)

Deductions Specifically Denied

- No deductions for: (26 specifically denied, even override 8/25—even deductible under 8)
- **Penalties: s. 26-5 ITAA 1997** (fine, *not civil* penalties, it is state and federal fine) (speeding and parking → even though while work)
- Expenditure relating to **illegal activities: s. 26-54** (drug carrying→not deductible)
- **Provisions for leave: s. 26-10** (***not deductible until leave***, set aside provision know, meet liabilities in the future → want & **actually take leave & I pay them; not salary**, not for working purpose)

- See Division 26

Bribes

- Bribes to public officials: **s. 26-53**
 - You **cannot deduct**...a loss or outgoing you incur that is a *bribe to a public official (domestic)
- Cf. rules on bribes to **foreign public** officials: s. 26-52
 - You cannot deduct ... a loss or outgoing you incur that is a *bribe to a foreign public official ... An amount is not a bribe to a foreign public official if (a) the value of the benefit is of a minor nature; and (b) the amount is incurred for the sole or dominant purpose of expediting or securing the performance of a routine government action of a minor nature ... (jurisdiction where bribe is→business, commonly known corrupt act, incentive payments, not operate until bribe)

Depreciation for Capital Expenditures

2 main Division: (cannot be both, mutually exclusive)

- “Depreciating assets”: **Division 40 ITAA 1997**
- “Capital works”: **Division 43** (buildings→not fixtures in buildings, the actual shelf shed)
 - Excluded from Division 40: **s. 40-45**

Capital Allowance

- Deduction for **depreciating assets**: **s. 40-25(1) ITAA 1997** (uniform, allow deduction for capital expenses,)
 - Scope: “depreciating asset”:
 - Definition in **s. 40-30 ITAA 1997**
 - Taxpayer: “**held**” (to get deduction, otherwise lump sum—big deduction at first, flat out expense—nothing later)
 - Definition: **s. 40-40 ITAA 1997**
 - Include: “owner” of the asset: item 10 (but unclear for certain leases)
 - Amount: “**decline in value**” (not call depreciation in tax = depreciation)
- Subject to:
 - Apportionment rule: **s. 40-25(2)** (partially for business and partially for personal; business→private—only deduct for time for business→still hold though; do you get deduction for decline in value → business only)
 - “Taxable purpose”: **s. 40-25(7)**

Depreciating Asset

- **40-30(1)** 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, **except**:
 - (a) land; or
 - (b) an item of *trading stock; or
 - (c) an intangible asset, unless it is mentioned in section (2) (other regime)
- **40-30(2)** These intangible assets are **depreciating assets** if they are **not** *trading stock: (exhaustive list)
 - (a) *mining, quarrying or prospecting rights...
 - (c) Items of ***intellectual property**... (arts, patents, depreciable asset)
- US amortisation regime for acquired intangibles covers: (compare, intangible list broader than AUS)
 - Goodwill

- lists of current and prospective customers
- formula, knowhow, franchise, trademark, trade name
- covenant not to compete
- “customer-based intangibles” (e.g. market share)
- “supplier-based intangibles” (e.g. favourable supply contract)

Decline in Value

- “start time”: (When start decline in value—take out of box, ready for you to use it)
 - “first use” or “installed ready for use”: **s. 40-60 ITAA 1997**
- 2 Alternative methods for each depreciating asset: **s. 40-65** (asset by asset basis, appropriate)
 - **Prime cost** (i.e. straight line): **s. 40-75**
 - **Cost/effective life X Days held/365** (same cost)
 - **Diminishing value**: **s. 40-72**
 - **Base value/effective life X (Day held/365) X 200%** (base value=cost in year 1, Y2: cost – last year depreciation, keep reducing value depreciation for)
 - **Not available** for certain intangible assets: **s. 40-70(2)** (practice purpose)
 - Cannot change method once chosen: **s. 40-130(2)** (asset by asset, can choose different method, but cannot change one asset) (if choose diminishing value—bigger up front deduction, but switch→deduction is larger than cost) (diminishing value—deduction are bigger at first)

Year	1		2		3		Value c/f
Prime Cost	100	-10	90	-10	80	-10	70
Diminishing Value	100	-20	80	-16	64	-13	51

80—adjustable value, 20—higher deduction, 70—adjustable value

Effective Life

- A choice between: **s.40-95(1) ITAA 1997**
 - “Self-assessing” and (justify, expert compare and assess, flexible reflection of income position, wear and tire on certain assets, claim over, quarentity suvier advice)
 - Commissioner’s figures: **TR 2015/2** (how long that last or use, choice) (list every asset and tell each if use it, safe)
- except: statutory figures for certain intangible depreciating assets: **s. 40-95(7)**
 - For example, standard patent (20 years); registered design (15 years) (standard, cannot self-assess, cannot change)
- “Self-assessing”:
 - criteria: “reasonably wear and tear” and “reasonable maintenance”: **s.40-105 ITAA 1997** (not completely destroyed)
 - may change due to “changed circumstances”: **s.40-110** (can reassess life, more reflective on wear and tire)

Cost

- 2 elements: **s.40-175 ITAA 1997** (reduce cost of assets)
- **1st element**: “the amount you pay” to hold the dep. asset: **s.40-185(1) item 1**
- subject to various **adjustments**: (related party) (anti-avoidance reason)
 - m.v. substitution: **s.40-180 item 8**
 - apportionment: **s.40-195** (2 assets)

- no double deduction: **s.40-215** (based on MV)
- exclude non-capital expense: **s.40-220** (deduct more otherwise)
- **2nd element:**
 - amount paid to bring the asset to its present condition and location, and
 - Expenditure reasonably attributable to a **balancing adjustment event**: **s.40-190 ITAA 1997** (=dispose, both sale &)
- cf. definitions of c.b. and r.c.b.: **why different**
 - (depreciation is not equal to CGT, depreciation is to pick up expenditure through life, periodical; CGT is cost base and reduced cost base wholly at end)

Balancing Adjustments

- Definitions: **s.40-285 ITAA 1997**
 - “balancing adjustment event”
 - definition: **s.40-295 ITAA 1997** (e.g. cash register upgrade) (balance depreciate adjustment, depreciation claimed, actual MV, too much depreciation or not depreciate enough—deduct at end)
 - include “**stop holding** the asset”, “**stop using** it” forever
 - “**termination value**” (get the rest of deduction not claimed, even not hold asset anymore, if $TV > AV$ — difference include in AI, if $TV < AV$ —difference as deduction)
 - definition: **s.40-300 ITAA 1997**
 - basically, **disposal proceeds**: **s.40-305**
 - subject to adjustment rules, e.g.
 - ✓ **m.v. substitution**: **s.40-300 item 6**
 - ✓ apportionment: **s.40-310**
 - “**adjustable value**”
 - definition: basically tax **written down value** + addition to 2nd element: **s.40-85 ITAA 1997**
- Difference between **termination value** and **adjustable value** (**40-285**)
 - A.I. or deduction
 - reconciliation between actual decline in value and capital allowance allowed
- Reconciliation with CGT regime
 - In general, disregard capital gain/loss on depreciating asset: **s.118-24 ITAA1997**
 - (use different concepts, CGT and Depreciable assets, if depreciate asset wholly, not CGT, 180-4, wholly taxable purpose, **partially private**→CGT event except CGT K7, not use CB, RCB, use depreciation, use cost of asset, not CB)

Special Capital Allowance Regimes

Small Cost Assets

- **Immediate** deduction: **s.40-80(2) ITAA 1997** (cheap)
- conditions:
 - cost not exceed \$300
 - Used predominantly for producing A.I.
 - not used in a business, and
 - total cost of identical assets or **set** of assets: **not > \$300**
 - (rental/residential/investment property—fixtures immediate deductible)

Low-value pool

- Taxpayer can choose to pool low-cost and low-value assets and depreciate the pool over 4 years (at accelerated rates) under diminishing value method: **s.40-440 ITAA 1997** (full rate/half rate)
- conditions:
 - low-cost assets: cost < \$1,000 + “all in” rule: **s.40-425(2) & 40-430(1)**
 - If choose to pool, all low-cost assets must be allocated to pool; taxpayer can choose to allocate low-value assets (once have, forced to put all low cost asset inside, >1000, hold for a while, <1000)
 - low-value assets: tax written down value (under d.v. method only) < \$1,000: **s.40-425(5)**
- irrevocable choice: **s.40-430(2)** (hard to get rid of, hold asset together and as one asset, basic standard rates, other option accelerate rate, depreciate quicker) (cannot unwind—only can depreciate all and not buy new)

Concessions for SBE (small business entity)

- **Subdivision 328-D ITAA 1997**
- Assets with cost < \$1,000: immediate deduction: **s.328-180**
 - Temporary increase of threshold for assets acquired between 12 May 2015 and 30 June 2017: cost of asset < \$20,000 (turnover < 6 million)
 - Threshold was increased to \$6,500 for assets acquired between 1/7/2012 and 31/12/2013
- Other assets: basically depreciate in a **pooling system** at 30% under diminishing value method (immediate deduction, SBE—so not low value pool, small business pool, most assets—general pool/long life pool: depreciate as one, half rate if 50%)

SBE Pool

- once in the pool, not out even if stop being SBE: **s.328-185(7) ITAA 1997**
- if value of pool < \$1,000, fully deductible: **s.328-210**
- first year depreciation: **at half the rate: s.328-190(2)** (year buy asset and put it in use)
- disposal: proceeds deducted from pool: **s.328-200**
 - if value of pool becomes **negative**: A.I.: **s.328-215** (method: over depreciation)

Project Amount

- basically depreciate the pool over “project pool life” under d.v. method: **s.40-830 ITAA 1997**
 - Project life: **number of years** that the project will operate: **s.40-845 ITAA 1997** (predicted amounts)
- definition of “project amount”: examples of ex-blackhole expenses: (blackhole expenditure)
 - create/upgrade community infrastructure
 - site preparation
 - feasibility study for project that is carried out
 - (pool project together, pool all together)

Business Related Costs

- depreciate over 5 years on straight line basis: **s.40-880 ITAA 1997** (blackhole expenditure)
 - Original provision only covered capital expenditures on certain transactions, including:
 - business structure (restructure)
 - equity raising
 - defending against takeover
 - liquidating a company
 - Current provision: comprehensive scope covering “business related capital expenditures”

- Proposal: immediate deduction of certain SBE start-up expenses
- A “provision of last resort” (do everything else first, CGT, Blackhole expenditure)

Car Limit

- Cars: cost limited to “car limit”: s.40-230 ITAA 1997
 - **\$57,466** for 2014-15 and 2015-16 (only buy for \$57,466, limited to that amount)
- Why the limit? (partially is for private purpose, limit stay the same)

Capital Works Deduction

Capital Works (buildings)

- definition of “Capital Works”: **s.43-20 ITAA 1997**
- includes: (before: confined set of buildings, for specific purpose → expanded)
 - building, extension, alteration or improvement since **22/8/1979** (**dates*****, not any CW deductible before)
 - “structural improvements” since **27/2/1992**, e.g. sealed roads/driveways, bridges, pipelines, dams
 - environment protection earthworks since **19/8/1992**
 - (originally not have depreciated first, not use building in business, just carry on business in building (location) → rough decision)
- conditions: **s.43-10 ITAA 1997**
 - “construction expenditure **area**” (land, work out construction expenditure)
 - “pool of construction expenditure” (amount of money spend)
 - eligible use (table)
- deduction limited to “un-deducted construction expenditure” (full percent, high use → factor/motel)
 - based on “use period” (first use → end of proceeding year)
 - basically from first use to end of preceding year: **s.43-230(2)** (quantity)
 - include “notional” capital works deductions (what is the construction cost of CW, not mark-up value (MV/ purchase price), only construction, straight line, X days build/365)
- timing:
 - after “completion of construction of the capital works” despite use before completion: **s.43-30 ITAA 1997**
- deduction formula:
 - based on “**your construction expenditure**”: **s.43-210 & 43-215**
 - definition: portion of “**pool of** construction expenditure” attributable to the “construction expenditure area” that:
 - ✓ the taxpayer **owns**: **s.43-115**, or (straight line %)
 - ✓ the taxpayer, who incurred the expenditure, continues to **lease** the area: **s.43-120**

Deduction

- Depreciation rate: (**dates*****) (only industrial activity full) (distinguish purchase price, take out builder’s mark up)
 - 2.5% or 4% depending on use and date of commencement of capital works: **s.43-25, 43-140 & 43-145**
 - For example, rental property: 2.5% (4% if construction commenced between **22/8/84 and 15/9/87**)
- TR 97/25: Example of “Guiseppe the builder”

<http://law.ato.gov.au/atolaw/DownloadNoticePDF.htm?DocId=TXR%2FTR9725%2FNAT%2FATO%2F00001&filename=pdf/pbr/tr1997-025c1.pdf&PIT=99991231235958>

Balancing Adjustment—Destruction

- if all or a part of your **capital works** is destroyed, deduct “balancing deduction”: **s.43-40 ITAA 1997**
- “balancing deduction”: **s.43-250**
 - basically “un-deducted construction expenditure” less amount received for the destruction (balance out depreciation)

Balancing Adjustment—Disposal

- *No balancing adjustment for other cases: why?* (just for destruction take out deduction, D 43)
- deal with under CGT
 - CGT event A1
 - Adjustment to c.b. and r.c.b.: reduce by the amount of capital works deduction claimed on the property: s.110-45(2) & 110-55(4)
- *Why not consistent treatment as Capital Allowance?*
 - cf. Ralph Report recommendation (regime use its concepts, except depreciation concepts)

Ralph Report recommendation

- Problems of existing regime: A Platform for Consultation:
 - statutory life vs effective life
 - e.g. different quality of building materials (D43 not as reflective of quality and materials, not reflect different buildings)
 - wrong depreciation amount (based on purchase price)
 - construction cost vs purchase price
 - wrong depreciation amount (flat—same life, not consider actual life)
 - ✓ international comparison: most developed countries, including the US, Germany, Japan, etc., adopt purchase price
 - ✓ only major exception: the UK: An International Perspective
 - complex rules → **high compliance costs**:
 - improvement to existing building: treated as separate asset for capital works deduction purpose (pass cost to next person)
 - ✓ additional record keeping
 - construction cost records:
 - ✓ have to be passed on to each subsequent owner; or
 - ✓ professional valuations
- Ralph recommendation: same treatment as for other depreciating assets
 - not implemented (uniform capital allowance)

W10—Tax Accounting

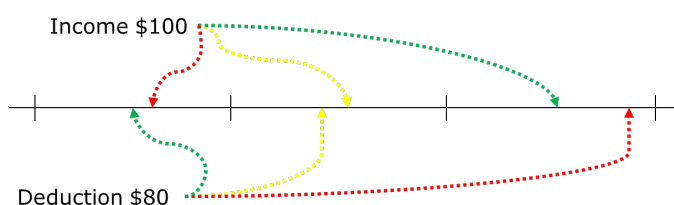
1. Overview (timing)
2. Cash vs accrual basis
3. Meaning of “derived”
4. Meaning of “incurred”
5. Trading stock (timing, own regime)

Review + Feedback

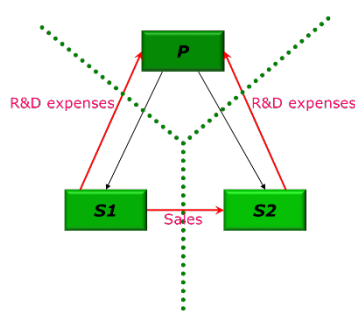
- A company carrying on a retail business can deduct a bad debt in an income year if **(1) income in that year**; and **(2) written off in that income year**. (accrual basis)
- Peter incurred \$70,000 to repair the office premise he purchased in this income year before moving his business in. He can deduct **\$ 0** in this income year under s.8-1 ITAA 1997. (premise—asset account, 8-1 → revenue account)
- Intellectual property is defined to mean (1) **patent** (2) **copyright**; and (3) **registered design**. (s. 995-1)
- Depreciation assets **exclude** (1) **land**; (2) **trading stock**; and (3) **intangible asset—list**
- A taxpayer in general can choose between **prime cost** and **diminishing value** methods to calculate capital allowance.
- Disposal of a depreciating asset is a **CGT A1 (Case 7)** event as well as a **balancing adjustment** event (depreciation regime), but it is dealt with exclusively under the **depreciation** regime. (uniform)
- A taxpayer in general can deduct immediately the cost of a depreciating asset if its cost is not more than **\$300**. The threshold is increased to **\$2000** for SBE until 30 June 2017.
- When a depreciating asset is disposed of, the taxpayer has to compare **termination value** with **adjustable value** to determine the gain or loss on disposal.
- Gary sold his investment property for \$900,000 in this income year. He acquired the property for \$500,000 ten years ago and has claimed capital works deductions of \$120,000. His capital gain from the disposal is **\$900,000 – 380,000 = 520,000 (→ &discount)** before discount. (D43—To the extent deducted, D43—deduct purchase price, reduce 1st element of cost base 500,000 by amount deducted (prevent double benefit); affect cost base add or deduct elements (CGT)) (Cost base: 380000)
- A taxpayer in general can choose between **self-assessment** and **commissioner** to determine the effective life of a depreciating asset.

Overview—tax accounting

- Why is tax law so complex?
 - Time
 - Space
 - John Prebble, “Why is Tax Law Incomprehensible?” (1994) British Tax Review no.4 pp.380-393 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1681810
- Time:



- (3) Income latter, deduction in front
- (1) Deduction not need to be same year, not need match



- Space:
 - Sales = \$100M
 - Total cost = \$80M
 - Group profit = \$20M
 - Parent: CMC (central management control), R&D
 - S1: manufacture
 - S2: sales & marketing

Carry out business as a group, intragroup transactions S1→S2

Annual Accounting

- “Your income tax is worked out by reference to your taxable income for the **income year**”: **s.4-10(2) ITAA 1997**
 - Theoretically **not** accurate measure of **ability to pay**: (account on year by year basis) (self-assessment)
 - *fluctuation of income* (cyclical type of business, snow fields)
 - *progressive tax rates*
 - *changes in tax rates* (different entity, arbitrage)
- In practice, always periodic: why? (easy to make everyone pay every year (not ability to pay))

Cash vs accrual basis

Income: “Derived”

- “**derived** ... during the income year”: **s.6-5(2) ITAA 1997**
 - definition: **s.995-1 ITAA 1997**
 - only refers to **s.6-5(4) ITAA 1997**: **constructive receipt rule** (not actually receive, assume to receive, instruct somebody to pay→get benefit) (derive include ordinary concept and constructive receipt rule)
- Some statutory rules on “**derived**”:
 - e.g. “**paid**” for dividend: **s.44(1) ITAA 1936** (SI: not actually concept of derivation→timing)
- Case law: 2 issues:
 - Cash vs accrual basis? (cash: all about receipt→if receive—derived, e.g. interest, 6-5 derived interest income when received; accrual: when get right to receive it—inappropriate)
 - If accrual, timing of “derive”?

Cash vs Accruals Basis

- *Cash basis (receipts basis)*: (cash vs accrual—income→when
 - income and deductions recognised upon **cash receipts and payments** (Proxy)
- *Accruals basis (earnings basis)*:
 - income recognised upon “**a right to claim**” (include in AI now, not matter not received yet)
 - deductions upon “an obligation to pay”

Carden’s Case

Fact:

- taxpayer: medical practitioner
- prepared accounts on cash basis
- after his death, payments received for outstanding accounts
- Tax office: argued that Dr Carden should have adopted accruals basis (put in his states, should account when receive bill)

Held: **cash basis**

- Reasons:
 - tax law in general silent
 - **choice** “must depend upon its actual **appropriateness**” to give (choice not prefer, but appropriate)
 - “**a substantially correct reflex of the taxpayer’s true income**” (cash or accrual)

- **“a question of fact”** (according to your condition, if give **true reflection**)

Henderson

- After Carden’s case, ATO adopted **cash basis** for **all professionals**
- Position challenged in **Henderson**
- Fact:
 - taxpayer: partner of large accounting firm
 - both taxpayer and partnership used to adopt cash basis (swaps)
 - partnership changed to accruals basis in 1965; taxpayer followed
 - Commissioner insisted on cash basis → professional

Held: **accruals basis**

- Reasons:
 - **s.90 & 91 ITAA 1936**: partners pay tax on their **shares** of income derived by the partnership (include shares in AI, partnership provision, net income of partners)
 - taxpayer should follow accounting method of partnership
 - **Accruals basis**: appropriate for **large accounting firm** (c.f. Carden’s case: sole practitioner) (what is appropriate—correct for switch – acceptable)
 - **“a substantially correct reflex of the taxpayer’s true income”**

Year 1 partnership swapped	Year 2
Cash basis here, I do issue → bill, not included, not derived	Accrual basis, pay in the Y2, not derived—right to claim

Firstenberg

- After Henderson, ATO changed practice and adopted **accruals basis** for professionals
- Led to yet another challenge in Firstenberg
- Fact:
 - taxpayer: solicitor **in sole practice** (sole trader)
 - adopted cash basis for 20 years
 - Commissioner: requested change to accruals basis (professional)

Held: **Cash basis**

- Reasons: (because small → the smaller, the simpler the affair, employee → cash basis; if big, can circulating capital → accrual)
- circumstances very different from **Henderson** (viz. sole practitioner vs large professional firm)
- accruals basis for the taxpayer would be
 - *“an artificial, unreal and unreasonably burdensome method”*
 - i.e. applied **Carden’s** principle

Summary—General rule

- **a correct reflex of the taxpayer’s true income**
- **a question of fact** (based on your facts and circumstances)

TR 98/1

- Though legally binding ruling, disclaimer by ATO: (guides/factors to work out what is appropriate)
 - the ruling *“is not intended to be prescriptive; rather it should be used as a guide”*
- Cash basis: *“likely to be appropriate”* for (Not a harden fasten rule)
 - employment income

- personal professional services
- investment income (dividend interests)
- Accruals basis: “*in most cases*” appropriate for
 - trading and manufacturing businesses

Deeming Rules on Receipts

- **Non-cash receipts:** (Assume **market value** deemed consideration received/paid → pay on money amount)
 - **market value** of consideration: deemed to have been paid: **s.21 ITAA 1936**
- **Constructive receipts:**
 - **deemed receipt** if the amount “is applied or dealt with in any way **on your behalf** or as you direct”: **s.6-5(4) & 6-10(3) ITAA 1997** (direct to pay somebody, my choice, not turn any income into income, not make anything not income income, if not have **beneficial entitle** → not income)
 - only applies after establishing that amount in question is “**income**” : **Howell**

Cash Basis—Deduction

- “Cash basis for income → cash basis for deductions”: logical? (**8-1** incur—to the extent)
 - Supported by English income tax rules, Asprey Report, Parsons: *Income Taxation in Australia*
 - Some argue that “**incurred**” implies accruals basis for deductions
 - e.g. ATO: **TR97/7 para.9**
- In practice, ATO position:
 - Provided **consistent** over years, taxpayers adopting cash basis for income can use cash basis for deductions: **TR 97/7 para. 12**

“Derived”

Recognition of Income

- Timing of “derivation” under **accruals basis**? (not clear cut, not like cash)
Example: (proper years, right to debt, legislation can affect **timing**)
 - tax consultant signs contract with client to provide tax advice for fixed fee
 - performs work
 - issues bill
 - bill due but not yet paid by client (still time to ask for money)
 - client pays (right arrive before pay)
- Under **accruals basis**: (unclear when the **right** arises)
- income is realised when “fees have matured into **recoverable** debts”: **Henderson** (if can recover)
- May need to account for “work in progress” (work done but not yet built)

Ballarat

Fact:

- taxpayer: a brewer
- sold products with discount for prompt payments (only discounted amount, not full amount)
- discount almost never refused
- reported income *net of expected discount*
- Commissioner: tried to tax *gross price* (full amount, on accrual basis, claim and deduction)

Held: **for taxpayer (Discounted amount)**

- Reasons:
- company's figure represented "what the company will, in the light of all past experience and policy, **almost certainly** receive ..." (wired to receive gross)
- Commissioner's figure: "almost certainly" will not be received in full → misleading figure (not true/clear reflection)
- "**uncertainty of eventual receipt**": may not affect recognition if the uncertainty is very remote (if good guess → good basis for that figure)
- *Consistent with accounting rules?*
- ATO position after **Ballarat: TR 96/20**
- General rule: still recognise "full invoice price"
- only exception: (unless, only in this time **discounted amount, otherwise full**)
 - if facts are "on all fours with" Ballarat
 - i.e. "there must be **virtual certainty** ... that the amount of discount will not be received"

BHP Billiton Petroleum

Fact:

- taxpayer: sold petrol products
- new resources tax was levied on taxpayer
- tried to pass on the tax to buyers, and issued invoices accordingly (pass on buyers to pay tax amount)
- buyers refused, resulting in protracted litigation
- Commissioner: tried to tax the pass on amount (to the buyer)
- Taxpayer: argued that income not "derived" until dispute settled
- (Question on **certainty** until decided)

Held: **for taxpayer**

- Reasons:
- recovery of the pass on amount **uncertain** and outside control of taxpayer
- derivation should be deferred until dispute settled
- avoid problems of re-opening assessments and unfairness to taxpayer
- **Eventual receipt should be sufficiently certain** (consistent with **Ballarat**)
- *Consistent with accounting rules?*

Arthur Murray

Fact:

- taxpayer: provided dance lessons (sell lessons for 10 months, pay in front)
- received lump sum fees in advance
- contract: stated "**no refund**", but in practice sometimes refund
- only reported fees attributable to lessons already taught (suspense account → transfer suspense → end account, only use after transferred)
- Commissioner: tried to tax **whole amount** upfront (end account)

Held: **for taxpayer**

- Reasons:
- decision should base on "general understanding among practical business people of what constitutes a **derivation of income**"
- receipt "subject to contingency" of possible refund: "received" but not "earned"

- **Income can be “received” but not yet “derived”** (beneficial entitlement, only for service, not performed services yet, not entitle suspending fees, **no rights**, not really about refund → performed or not — no beneficial account)
- *Consistent with accounting rules?*

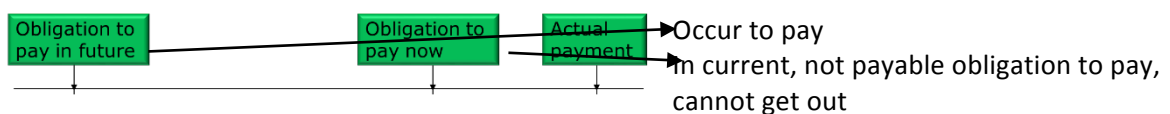
Summary—general rules

- **right to claim payment, &**
- **eventual receipt should be sufficiently certain**

“Incurred”

Recognition of Deduction

- “incurred”: **s.8-1 ITAA 1997**
 - case law
 - **definite liability to pay: New Zealand Flax Investment (case)**, TR 97/7



Require liability to pay

James Flood

- *Fact:*
- taxpayer: company which accrues **annual leave** for employees
- **Leave entitlement** might be lost if employee dies, employment **terminated** due to his own fault, etc.
- taxpayer tried to claim deduction for the accrued leave (set up provision, deduct provision)

Held: not “incurred”

- *Reasons:*
- entitlement subject to **contingencies**
- **no definite liability** to pay
- (no obligation until actually take leave, expected pending, not yet incurred, termination clause even without → not incurred)
- *Consistent with accounting rules?*

Accrued Leave

- Principle in **James Flood:**
 - reaffirmed in *Nilsen Development Laboratories*: “incurred” only when “the employee enters upon a period of leave” (could terminate)
- To remove further doubt, tax law changed in 1978 (before the High Court handed down the decision on *Nilsen*):
 - **no deduction** of leave payments **until paid: s.26-10 ITAA 1997** (no liability to pay until leave taken, specific deduction denial promiser)

RACV Insurance

- **Question: Can “estimated liability” ever be “incurred”?** (amount have to be sufficiently certain → have to know the amount)
- *Fact:*
- taxpayer: insurance company (estimated, estimated liability deduction)

- **claimed deduction** for “unreported claims” (constitute huge amount → predictable based on history)
- amount proved to be conservative, much lower than the actual amount
- expert witness: matching principle very important in **insurance business** (under legislation, not know amount)
- Question: Can “estimated liability” ever be “incurred”?

*Held: **for taxpayer*** (not applicable outside insurance, unless similar legislation)

Reasons:

- special circumstances for insurance industry
- taxpayer’s account: a **true reflex** of its income
- **Estimated liability: if almost certain, may be “incurred”** (if without—not true reflection, special condition of insurances, legislation of insurance)
- *Consistent with accounting rules?* (claim constructive deduction ← certainly not less than that amount)

Australian Guarantee Corp.

- **Issue: Mismatch between “incurred” and “payment”**

Fact:

- Taxpayer issued debentures
- obligation to pay interest: deferred until redemption (up to 20 years later)
- sought to deduct accrued interest

*Decision: **for taxpayer:***

- Reasons:
 - **present liability to pay** → “incurred” (not matter deferred, cannot avoid)
- **Asymmetric** treatment between payer and payees → tax avoidance
 - Now subject to **TOFA**: effective 1/7/2009 (large taxpayer, match income and deduction)
 - Accrue interest over period on compound interest basis
 - Symmetric treatment for payer and payee (in order to deduct but not occur in the future)

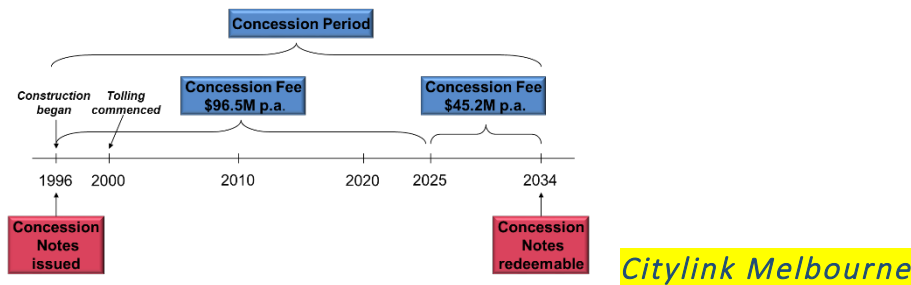
Coles Myer Finance

Fact:

- finance company issued a short-term bill at a discount
- term of bill over 2 years
- taxpayer: argued for immediate deduction (based on AGC)
- Commissioner: argued for deduction only upon redemption

*Held: **pro-rata deduction over term***

- *Reasons:* (matching principle)
- discount → “present obligation to pay” → “incurred”
- **BUT**, new concept: “there remains the question: how much of that ... outgoing is **referable** to the year of income?” (referable—period)
- *Consistent with accounting rules?* (case use only for **financial instruments**)



Concession fee: discharge liability, claim own liability

Present liability to pay upfront

- Federal Court:
 - (1) “incurred” & “referrable”
 - “Such an outcome might be seen to be something that might only be expected in a **taxpayers’ heaven**” (referrable to each income year → not need to pay until 2034) (mass deduction, not need to pay until.
 - (2) “share of profits” or capital expenditure
- Full Federal Court:
 - (1) but not (2)
- High Court: ditto—same as FFC

Summary—general rules

- **present obligation to pay** (to be incurred)
- **amount sufficiently certain**
- **referable** (caution—only for financial instruments)

Prepayments

- Tax avoidance: (massive large amount upfront → up to each year amount)
 - used to be deductible upon payments: **FCT v Lau (1984) 6 FCR 202**
- 1988: **Subdivision H Division 3 Part III ITAA1936: (82 KZM** section → prevents prepayment → not deny deduction → bring to year referable → appropriation over days basis)
 - in general, **spread over service period** (maximum 10 years) (appropriation deduction over 10 years)
 - **Exceptions** include:
 - < \$1,000
 - Prepayment of salary/wages
 - For SBE or non-business expenditure of individuals:
 - ✓ Service period not > 12 months AND ends within next income year

Trading stock

Trading stock

Definition:

- inclusive: “anything produced, manufactured or acquired that is held for purposes of manufacture, sale or exchange in the ordinary course of business”, and live stock: **s.70-10 ITAA 1997** (on shelf, anything turnover, anything sales) (codified provision, when amount incurred and derived)
- wide scope: including
 - land: **Kurt Development, St Hubert’s Island**
 - shares: **Investment & Merchant Finance Corp, Patcorp Investment**

Tax Accounting Rules

- similar to accounting rules:
- expenditure incurred on t.s. “**on hand**” → deductible: **s.70-15 ITAA 1997** (when deductible specify) (**s. 8-1**) (deduction: **8-1**, sells ordinary income **6-5**, timing: **s. 70**) (increase inflate prices)
 - subject to arm’s length adjustment: **s.70-20** (a response to **Cecil Bros**) (right to dispose)
- never capital expenditure: **s.70-25** ((1) deductible under **8-1**, capital—deny deduction, not fail **8-1**; (2) revenue, not capital **6-5**)
- Compare opening and closing stock “on hand”: **s.70-35** (at beginning and end of the year—not get a whole massive stock to claim deduction→true reflection of true income)
 - if **closing > opening: assessable income**
 - If **opening > closing: deduction**
- **disposal** of t.s. → A.I.: **s.70-80(1)** (assess **timing**) (sell)

Trading stocks “On Hand”

- General rule:
 - dispositive power → “on hand”: **Farnworth**
- Exception:
 - land as trading stock
 - “on hand” **until settlement: Gasparin**

Valuation of Closing Stock

- Can choose between **3 methods** for **each item** for **each year: s.70-45 ITAA 1997**: (can do comparison, can choose whichever method for each year, choose item basis, or others)
 - Cost
 - market selling price
 - replacement value
- May value lower for obsolete stock: **s.70-50** (additional valuation rule)

Non-arm’s length acquisition

- If cost of **t.s. > m.v.** in non-arm’s length transaction: **s.70-20 ITAA1997**
 - Cost deemed to be m.v. (not the inflated price)
 - Symmetric adjustment for seller

Disposal outside Ordinary Course of Business

- e.g. gift, sale of business, distribution of t.s. upon liquidation (e.g. *St Hubert’s Island*) (dispose, not ordinary way of market value)
 - **m.v.** deemed as A.I.: **s.70-90 ITAA 1997 (MV)**
 - **IT 2659** & annual TDs for values of t.s. for private use
 - symmetric treatment for acquirer: **s.70-95**
- similar rules for death of owner: **s.70-105**
 - Rollover: can be elected if continue to be held as t.s. in continuing business after death (Partnership get whatever calculated at that time→continue valuation process)
- (avoid stock take—have to do)

Trading Stock ↔ Non-Trading Stock

- non-t.s. → t.s.: **s.70-30 ITAA 1997**
 - Deemed cost of t.s. = actual cost or m.v.
 - if elect for **m.v.**, may result in capital gain/loss: **CGT Event K4: s.104-220** (market value, rather than actual value)

- if actual cost = 0, may substitute with m.v. at acquisition time: **s.70-30(4) item 1** (private in nature)
- t.s. → non-t.s.:
 - deemed **disposal at cost: s.70-110** (a different outcome from **Sharkey v Wernher**) (closing store → own use, include cost amount into AI)

Trading Stock for SBE

- Concession: **Subdivision 328-E ITAA 1997** (comply saving reasons)
- Do not need to account for change in values of t.s. if:
 - difference between opening stock and “the value you **reasonably estimate**” of closing stock **≤ \$5,000**
- Effect:
 - avoid stocktake (inventory computer system, ≤ 5000, use open stock, and carry for next period, open of the next year = close, open = close)
 - value of closing stock = value of opening stock
- Can choose not to adopt “concession”: **s.328-285 ITAA1997** (has to do stocktake)

W11—Tax Avoidance

1. General anti-avoidance provision
2. International tax avoidance – Apple

Revision + Feedback

- The **Carden** is the classic case on the choice between cash and accrual basis, which is a question of **fact**. The case establishes the principle that the tax accounting basis must provide a substantially **correct reflection** of the taxpayer’s **true income**.
- The key word for tax accounting with respect to ordinary income is **derived**. For accrual basis taxpayers, it depends on two factors: (1) **whether it is been earned** and (2) **right to claim (beneficial ownership/interest)**.
- Common examples of cash basis are (1) **SBE**; (2) **Professional/individual** and (3) **employees**.
- The **constructive receipt** rule deems receipt of an amount if the amount is applied or dealt with on behalf of the taxpayer or as the taxpayer directs.
- For accrual basis taxpayers, the key word for tax accounting in respect of expenses is **incurred**, which has 3 factors: (1) **present obligation to pay**; (2) **amount sufficiently certain**; and (3) **referable**.
- Provisions for annual leave are **not deductible** under **s.26-10 ITAA1997**. (until paid)
- Gary carries on a second-hand car business and gives a BMW (cost \$50,000 and m.v. \$40,000) from his trading stock to his daughter Mary as her birthday present. Gary has to report **\$40,000** as his assessable income in his tax return. The cost of the car to Mary is **\$40,000**. (disposal of trading stock, **disposal price = MV**)
- Same as above, except that Gary takes the BMW from his trading stock and uses it as his own car. He has to report **\$50,000** as his assessable income in his tax return. (Cost → stop to be trading stock, still own that stock)

Tax Avoidance

- **What is tax avoidance?**
- “some act by which a person so arranges his affairs that he is liable to **pay less tax ...**” [the *Radcliff Committee, UK, 1955*] (diminishing depreciation)
- “every attempt **by legal means** to reduce tax liability ...” [the *Carter Commission, Canada, 1966*]

- A spectrum: **No tax planning** → **Acceptable tax planning** (according to law, but it is not along the spirit of the ACT object and intention; 2 depreciation formula, diminishing value, choice intended by law) → **unacceptable tax planning** (loopholes in law, interpret in way not acceptable/ should not)—Part IVA applies → **Tax evasion** (criminal offence); (acceptable tax planning and unacceptable—morally, tax planning: immoral rather than illegal)
- Examples:
- Domestic:
 - Timing: (regime)
 - Defer income recognition (time value of money,
 - Accelerate deductions
 - Tax rate arbitrage:
 - Personal services income (different rates between entity → personal or business 30% arbitrage between people, trust & partnership)
 - Income splitting through partnerships and trusts
- International: base erosion profit shifting (**BEPS**) (test globally, take together, not jurisdiction loss competitive advantage) (OECD: profit shifting, prevent one country from hurt investments)
 - Double non-taxation: e.g. Apple (release taxpayer but not tax in any country)
 - Avoided PE structure: e.g. Google (PE: permanent establishment in AUS, shop/office location where foreigners operate in AUS, anything not go into PE, not taxed, everything go into PE, taxed) (provision of public goods)
 - Double dip: e.g.
 - Hybrid entities (tax regime arbitrage, limited partnership → partner behind, not recognised as company in AUS)
 - Hybrid instruments (redeemable preference share, recognise as equity and debt; equity: frankable → not deductible, and debt → interest pay deductible → double dip in one amount)
 - Transfer pricing (inflate intragroup, decrease income, entity A massive deduction, wrap out income, B: income should be in A but in B)

General Anti-Avoidance Provision – Part IVA

- Key concepts: **s.177D** (definition: 177A) (division 4A, 1936) (satisfy all) (3)
 - “**scheme**”
 - “**tax benefit**”
 - “relevant taxpayer”
 - 8 matters
 - “**sole or dominant purpose**”: **s.177A(5)**
- Effect:
 - Commissioner’s discretion to cancel (or partially cancel) tax benefit: **s.177F** (part 4A determinations; identify—no longer get)
- 177D SCHEMES TO WHICH PART APPLIES** (operative provision)
- (1) This Part applies to a scheme if it would be concluded (having regard to the [8] matters in subsection (2)) that **the person...who entered** into or carried out the scheme or any part of the scheme did so for the purpose of: (not need to be the same person, not have to be a relevant tax payer; bank → clients, bank strategies to attract more customer)
 - (a) enabling the “**relevant taxpayer**” to obtain a tax benefit in connection with the scheme; or
 - (b) enabling the “relevant taxpayer” and another taxpayer (or taxpayers) each to obtain a tax benefit in connection with the scheme;

- (4) Part IVA only applies to the scheme if:
 - (a) scheme was entered into after 27 May 1981; or
 - (b) Scheme has been or is **carried out or commenced to be** carried out **after that day...**
- (5) Applies to schemes entered into or carried out in Australia or outside Australia or partly in & out of Australia. (in—4A, out, or part in and part out, used to be wholly domestic, double dipping (equity)→avoid of NIL tax not AUS→cross broader)

Scheme

- Definition: **s.177A(1)** (broad definition, try to capture every kind) (***)identify actual scheme)
 - (a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable ... ; and
 - (b) Any scheme, plan, proposal, action, course of action or course of conduct.
- Very important concept: affect “**dominant purpose**”
 - Wider vs narrower schemes: e.g. steps 1 to 10 → one scheme and several schemes? (in one transaction (deduction) ***)scheme→may just be step 9, or 6-9, or whole, but clearly identify which part of step/ deduction obtain tax benefit→**dominant purpose** for **tax benefit**)
 - **Which version would ATO prefer?** (part 4A successful, if include **commercial reason steps**→4A fails)

Tax Benefit

- Definition in **s.177C** ITAA 1936, including: (executive list) (must be one)
 - Non-inclusion of A.I. (if not carry step 9, will not include loss as assessable income)
 - Additional deduction (extra deduction would not carry out if not carry out scheme)
 - Capital loss
 - Foreign income tax offset (tax resident) (get additional foreign income tax offset by step 9)
 - Avoid withholding tax (WHT dividend, interest royalty paid off shore→chase the person to get pay tax or not→withhold before offshore, bank must withhold before pay→in step 9→not need to pay withholding tax, meet WHT)
- For schemes entered into on or after 16 Nov 2012, the tax benefit must be determined based on: (amendment 4A amended, relive double tax)
 - events or circumstances that actually happened or existed (other than those that are part of the scheme);
 - A **reasonable alternative** postulate, having regard to the substance and result/consequence of the scheme.

8 Matters

- Listed in **s.177D(2)** ITAA 1936 (dominate purpose of tax avoidance) (4.5.6 relevant taxpayer, director penalty, who get what, what got scheme between linkages of entities involved)
- Need to **consider all**, but not necessary to refer to in a judgment (all 8 or first 3. Require all 8→take all into account)
 - A “global assessment of purpose” is acceptable: *Consolidated Press*
- **(i)** the **manner** in which the scheme was entered into ...; (compare legal form vs substance→substance of scheme = legal form, A—liability→B, legally give rise to liability; liability of A secured by B→not really a liability→not actually needs to pay→liability raise because need liability to AI, but legal liability)
- **(ii)** the **form** and **substance** of the scheme;

- (iii) the time at which the scheme was entered into and the length of the period during which the **scheme was carried out**; (massive deduction before year end—indicate tax avoidance)
- (iv) the result in relation to the operation of this Act that ... would be achieved by the scheme;
- (v) any change in the financial position of the relevant taxpayer ...;
- (vi) any change in the financial position of any person who has ... any connection (whether of a business, family or other nature) with the relevant taxpayer ...;
- (vii) any other consequence for the relevant taxpayer, or for any person referred to in subparagraph (vi) ...; and
- (viii) the nature of any connection ... between the relevant taxpayer and any person referred to in subparagraph (vi)
(FS: include all steps rather than only step 9 (scheme), argue what would transaction if step 9 not happen, include actually happen, sufficient to argue do nothing scenario, alternative hypothesis is reasonable→consequence of scheme, case RCI→could have done nothing sufficient argue against commissioner, court: **unreasonable**—RCI won)

Dominate Purpose (of tax avoidance TA)

- Means “the ruling, prevailing or most influential” purpose: **Spotless** (**TO identify scheme properly)
- Can co-exist with other commercial purposes: **Spotless** (**can have multiple purpose, TA is more than commercial)

High Court Cases

- Part IVA: enacted in 1981
- Peabody (1994)
- Spotless (1996)
- Consolidated Press (2001)
- Hart (2004)

Peabody (1994)

- 1st High Court case on Part IVA
Fact:
- major shareholder in private company wanted to float company
- purchased all shares from minority shareholder (at below listing price) (keep price confidential)
- made the shares worthless, then floated company (transaction value out (dividend))
- Issue: can Commissioner **isolate** value shifting **step** as the “**scheme**”?

Held: yes (reversed decision of Full Federal Court, which reversed decision at first instance, though the taxpayer won the case due to other technical issues)

Reasons:

- “a scheme does not include **part of a scheme** ... [**which is**] **not a scheme itself**. That will occur where the circumstances are **incapable of standing on their own** ... That, of course, does not mean that if part of scheme may be identified as **a scheme in itself** the Commissioner is precluded from relying upon it as well as the wider scheme”. (scheme stand by itself, if this step 9, can stand by itself (scheme)→narrower scheme or not work→ broader scheme, cannot be isolated, not achieve anything or the whole transaction)

Spotless (1996)

- 2nd HC case on Part IVA
Fact:

- company considered various investment options for its \$40M surplus cash
- decided to deposit in a **Cook Islands Bank**, though its rate was 4% lower than in Australia
- interest subject to a low w/h tax (after tax return is higher, tax pay is so low, chose to invest in Cook island purely because TA, exclude amount from AI)
- such interest as a result exempt from Australian tax (per prevailing law)
- after-tax return was thus higher
- Issue: Part IVA applies?

Held: yes (reversed the Full Federal Court's decision that the dominant purpose of the scheme was to obtain the higher after-tax interest, a sound commercial goal)

Reasons:

- In this case, the “**elaborate nature** of the scheme and its **attendant circumstances** lead inevitably to the conclusion that the scheme was **not merely tax driven** but that its **dominant purpose** was to enable the taxpayer to obtain a **tax benefit ...**” (not include interest in AUS, in AI, exemption claim by Cook island) (today—not sure—Part 4A failed down)

Consolidated Press (2001)

Fact: (redeemable preference share)

- CPH intended to takeover a UK company
- arranged finance in a particular way:
 - (1) borrowed \$450M from bank (raising finance circle substance—no money going anyway)
 - (2) subscribed redeemable preference shares in MLG(Aus)
 - (3) MLG subscribed shares in CPIL(UK)
 - (4) CPIL lent the \$450M to a Singapore group company for **the proposed takeover**.
- claimed deduction on interest on the \$450M loan
- Commissioner: argued step (2) was took just for tax purpose

Held: Part IVA applied

Reasons:

- scheme: “the Commissioner identified, as the relevant scheme, **part only of the total plan ...** involved in the corporate arrangements ... this is open to the Commissioner”
- *purpose:* “attributing **the purpose of a professional advisor** to ... the corporate parties ... is both possible and appropriate” (purpose of advisor vs people carry out)
- 8 matters: “it was not necessary for the judge to refer to the matters individually” (take advice, not actually do for you—can global look at)

Hart (2004)*** (demonstrate part 4A)

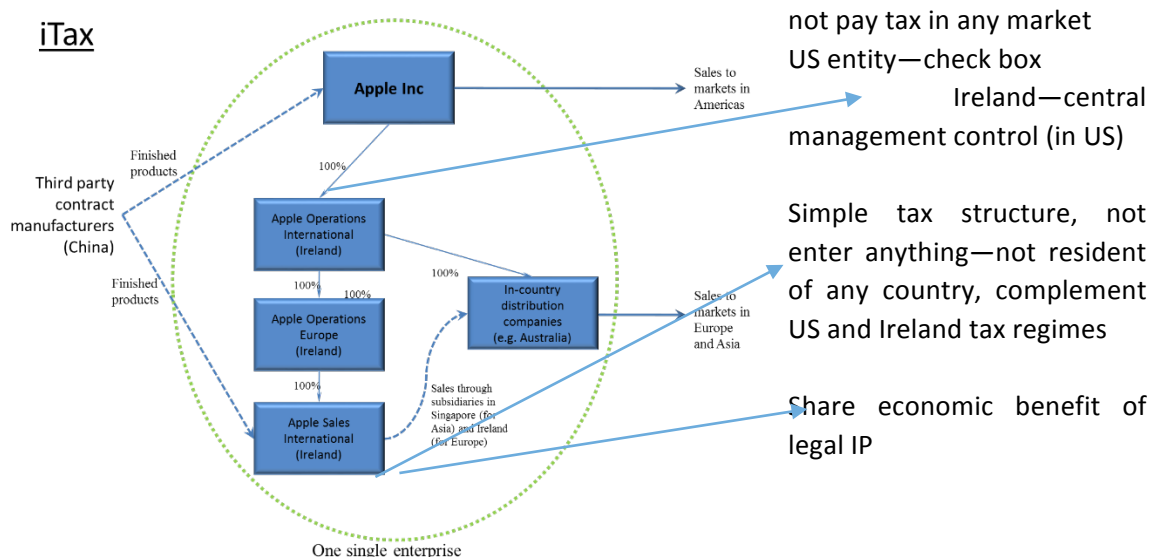
- The fourth HC case on Part IVA
 - Fact:* (negative gearing→D40/43 (1) Depreciate give deduction→give to investment property and (2) mortgage interest pay on loan is deductible on investment properties→as assessable income (rent), interest not deductible on home)
- taxpayer and his wife purchased house as new home, and kept original home as investment
- borrowed \$298,000 under split loan arrangement (one big loan for both property, principal go down all went to home, not match interest on home (capitalized), principal of investment increase→interest on capitalized increasing→ increasing interest deduction)
- repayments all allocated to “home loan account” til full repayment
- interest accrued on “investment loan account” **capitalized and compounded** (keep growing)
- Commissioner: disallowed “additional interest” (only here because not there)

Held: Part IVA applied (first instance: yes; Full Federal Court: no) (tax benefit—sole reason into scheme—was to reach interest deduction→no other commercial purpose)

- **Reasons:**
- scheme: “It encompasses **not only a series of (permanent) steps** ... but also (by its reference to “action” in the singular) the **taking of but one step**” (shifting to one side)
- Accepted both a **“wider”** (viz. the whole loan process) and a **“narrower”** scheme (viz. the splitting of loan and allocation of repayments to the home loan account) **identified by the Commissioner.**
- “The **“wealth optimizer structure”** depended **entirely** for its efficacy upon tax benefits generated by arrangements ... that had no explanation **other than their fiscal consequences**” (adjust amount, other than extra tax deduction by bank→but it is the couple need to pay tax) (bank provide the structure)

iTax:

- How did Apple shelter US\$44 billion from taxation anywhere in the world between 2009 and 2012?
- Reference: Ting, “iTax: Apple’s international tax structure and the double non-taxation issue” (2014) *British Tax Review* No.1 pp.40-71
- http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2411297



Creation of double non-taxation

- Definitions of corporate residence in Ireland and the US
 - Perfect complement
 - Recent change to definition of corporate residence in Ireland: a small win in the war on BEPS
- Transfer pricing rules on intangibles
 - **Cost sharing agreement:** information asymmetry (IP cost) (dis-appropriational, cost and income not match)
- US CFC regime
 - “relaxed” manufacturing exceptions
- US **check-the-box** regime (disable CFC, disagree intra sales)
 - Effectively disables US Controlled Foreign Corporation regime for intra-group sales, etc.

The tale of the check-the-box regime

- 1997:
 - The regime was introduced through Treasury regulations
- 1998:
 - US Treasury and IRS recognised the mistake
 - The CFC regime is effectively disabled to a large extent
 - Issued Notice 98-11 and corresponding proposed regulations to close the loophole
 - These documents “provoked controversy among taxpayers and members of Congress”: “firestorm”
 - The documents were promptly withdrawn:
 - Reminded of a scene in “Inside Job” (the Oscar-winning documentary)

US attitude towards BEPS

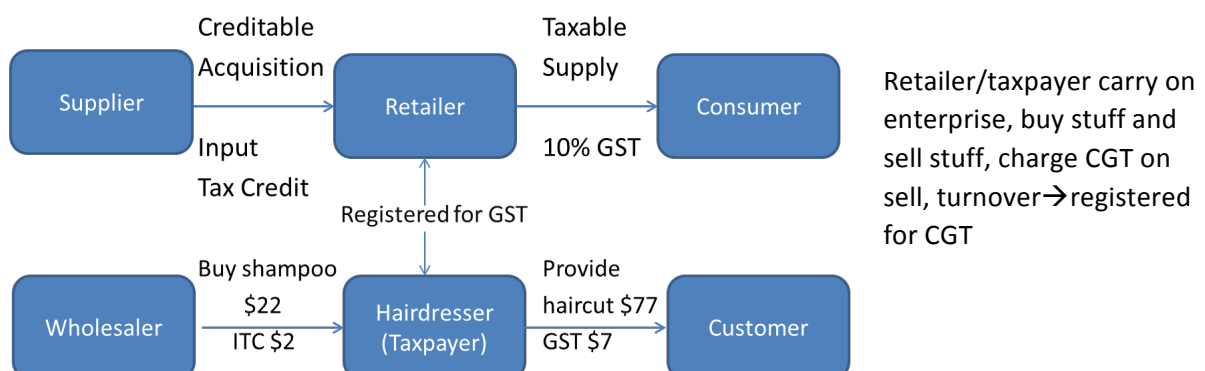
- Testimony of a prominent US tax lawyer before a US congressional hearing (emphasis added):
- Why should we – rather than the UK tax authorities – worry if [US MNEs] are employing strategies to minimize their UK taxes? ... Ultimately, in considering the appropriate reaction to [BEPS] whose primary impact is foreign tax minimization, we must consider carefully *whether the United States has an interest in imposing and enforcing rules whose primary beneficiaries are foreign fiscs*, rather than the US treasury. (defensive, anti, MNE—provide job, and economic consideration) (whether it is the best interest in terms of economy)

MAAL: s177DA Schemes that limits a taxable presence in Australia (apply to global level)

- Multinational Anti-Avoidance Law
 - Applies from 1 January 2016
 - Applies to **significant global entities**
 - \geq \$1bn annual global income
 - Accounting group member of such entity
- Applies where:
 - Foreign entity makes supplies to Australian customers
 - an associate Australian entity undertakes activities directly relating to that supply
 - Foreign entity avoids a tax presence in Australia in order to obtain an Australian and foreign tax benefit. (use entity not constitute PE, avoid double tax, no PE in AUS, not tax)
- Outcome:
 - Commissioner may cancel any tax benefits
 - Up to double the maximum administrative penalties may apply

W12—Review

GST—Overview



- ITC \$2 receivable from ATO; GST \$7 payable to ATO. (\$2 for CGT to provide taxable supplies → get \$2 from tax office, charge \$70 for services, \$7 for CGT)
- On BAS, net off: \$5 payable to ATO.
- Therefore, cost of shampoo for Hairdresser is \$20
- If the taxpayer is registered for GST (broadly annual turnover \geq \$75,000), and carries on an enterprise, then: (applicable or not) (not income if sent for tax office → if not registered, GST not affect, if registered for CGT, claim credit back → not \$7, just \$70 → bring in to AI, and if need to **depreciate**, cost, input credit back, if registered cost = \$20, if not registered cost = \$22 → in terms of **income and deductions**)
 - exclude GST component from income: s.17-5 ITAA 1997
 - reduce following amounts by ITC:
 - Loss or outgoings: 27-5
 - Cost or adjustable value of depreciating asset: 27-80
 - Terminating value, if the balancing adjustment event is a taxable supply 27-90
- GST collected by the taxpayer is not income of the Taxpayer.
- There is no deduction for an amount spent by the taxpayer if the taxpayer receives an ITC.
- Not relevant for employee taxpayers

Income and residency

- Assessable income made up of 2 types:
 - Ordinary income (s6-5) and statutory income
- Broadly 3 categories of income (3 categories → OI or not, more likely)
 - Personal exertion (salary, commission (services))
 - Property (rent, interest, royalty (IP), dividends)
 - Business (case)

Deductions*****

- Be methodical: (easy to be methodical)
 - General deduction 8-1: guidance to tell how to answer, check the list, follow the method, start with general deduction, if a specially ask what depreciation deduction → advise) (if general deduction → 8-1, checklist and **cases** → link to **every words** in 8-1) (“this expense is deductible because it is linked to positive limbs” X—need subject to **negative limbs**) (2 sides)
 - Specific deduction:
 - Div 25 (not mean cannot deduct under 8-1 → if deductible under both → which most appropriate → the bigger deduction)
 - Depreciation (2 methods, cost of assets element and 2 both formulated method. Holder use for taxable purpose → **appropriation** or **dispose**)
 - Trading Stock (70—actually OI—timing regime, comparison between operating and closing = special deduction, 3 parts: revenue/ deduction → when / comparing between opening and closing)
- CGT (→ income; **not deduction** for capital loss) (include amount in CB if not get deduction for amount incurred)(question: can include in CB → not use CB to calculate **capital loss**) (denial provision: equivalent in CGT regime)
 - Cost base/reduced cost base inclusion

- Blackhole expenditure: 40-880 (capital cost proposed to carry on, not deductible for capital in nature → deduct under 40-880: 5 years, **no day appropriation**, cost/5)
- Deduction denial provisions (26-5, 26-10 etc) (penalties, state law, not include person to person; 26-10 annual leave payments → deny until contingency happen)
- Ask: is any **case law relevant**??

General Deductions 8-1

- Elements: (checklist)
 - Loss or outgoing
 - Incurred in (present obligation, obligation to pay, existing to pay, not about timing to pay (when to pay) (**insurance** and telephone bill: insurance—optional, bill—use service—ability to sue)
 - gaining assessable income/carrying on business to gain assessable income (income producing activities → not actually have to produce income)
 - Not capital (capital: **Sun Newspaper**)
 - Case law
 - Not private or domestic
 - Typically private: food: Cooper—not deduction, clothing: Edwards (secretary of governor—over and above, condition to work, Qantas harsh condition, directly from work), travel from/to home (L&H, not linking to work and private in nature) etc)
 - Not for gaining exempt or NANE income (Dividend offshore)
 - No specific deduction denial provision applies (deduct denial provision → **D26**, enter 32, exception in **Div 32** → cancel denial → make 8-1 deductible)
 - penalties, leave payments (deny until contingency), payments to related entities, bribes, recreational clubs); entertainment; self-education expenses
 - Note: these provisions may deny the deduction outright or deny a portion of the deduction

Specific Deductions

- Div 25
- Travel between work places
- Protective clothing
- Repairs (25-10 maintenance case: improvement, replacement, initial repair → capital expenditure, part of purchase, case: Western Suburb Cinema Roof—no hypothetical deduction)
- Capital works (building 4% or 2.5%, 4 for high wear and tire—industrial appropriation on **daily basis** on construction expense)
- Depreciation (decline in value Div 40, work through 25) (use or not, not change depreciation deduction, when depreciation for taxable purpose) (appropriation → BAE compare) (balance out depreciation claimed, down to **written down** value) (dispose > written down value → depreciate too much 40-285, **terminating value > adjustable value**)

Depreciation

- Prime cost
 - $\text{Cost} \times \text{days held} / 365 \times 100\% / \text{EL}$ (days held: in income year, not over the whole life, has to be < 365)
- Diminishing Value
 - $\text{Base Value} \times \text{days held} / 365 \times 200\% / \text{EL}$ (base value → change every year, large up front)
- Balancing Adjustment: 40-285

- Compare Terminating value with opening adjustable value
- If TV exceeds AV, excess is AI
- If TV is less than AV, difference is deductible

Trading Stock

- 3 things to remember: (s 70—when tax return)
 - Sales = ordinary income under 6-5
 - Purchasers = general deduction under 8-1
 - Year-end adjustment: compare opening and closing stock (**closing increase**, difference → AI)

CGT

- Identify CGT event (The event must be the first to identify, dispose of shares, not C2, G1 → A1—any kind of property or legal right) (D1: create right to other people, restrictive covenant → pay to make promise → others can use you) (H: residual, Fs → leases) (specific section 104-5 not use the section, use the table, not operative, actual go to A1.....)
 - Common events: CGT event A1, C2, D1, H2 & Fs
- CGT asset (check CGT asset, collectable cost < \$500, ignore, personal use asset: \$10,000, exempt, disregards losses)
 - Collectables, personal use assets
- Exemptions
 - Pre-CGT assets (pre-CGT asset 1985)
 - Cars
 - main residence: rules to extend it; rules to limit it; spouses (118-B main residency)
- Capital Proceeds (CP: 116 whatever receive from selling asset)
- Cost base/reduced cost base (CB → RCB 5 elements, element 3, do not index RCB)
 - No inclusion if can be deducted (if deducted → not include in CB, not deduct to extent 110-45)
- Capital gain/loss (loss—RCB, gain if more than CB, loss if less than RCB, middle: nothing)
- Net capital gain/loss – method statement in 102-5 (how to calculate, box, NCG go to AI, SI figure)
- Discount capital gain (not D1: list out discountable, cannot discount D1—at least 12 month ownership, D1 right created today → maximise discount %)
- Small business CGT concessions: (328-110 → turnover, max net asset)
 - small business entity; max net asset value test; (basic condition: one of those SBE/MAX NA)
 - Active asset test (use asset for at least half of ownership period)
 - 15yr exemption; 50% reduction, retirement exemption; CGT asset rollover (15 yr choice first → **entirely disregarded CG**, 50% reduction → available for company; discount → not available for company) (retirement exemption → 50000)
 - Basic conditions; additional conditions

Tax Accounting

- About timing
- Cash (employee like, sole trader)
- Accruals (bigger, trading stocks)
- Income - Derivation
- Deductions – Incurred (loss of outgoing incurred)

Final

- Can use sentences, dot points, not too brief

- **CGT*****, SBE*******
- **Main residency*******, exemption, know well, change main residency rule *****
- Calculate depreciation, calculate BA
- Deduction denial
- SD provision
- Case law→8-1 deduction denial

Midterm Feedback

- 1. Have permanent visa→temporary visa not relevant
- Test: residency test→resident, apply when every time change of intention
- Ties→AUS, 3 month membership know many go back→not hold much weight, not = intention to not stay in AUS→still integral to AUS→still resident
- Break up→complete change of intention, from that point→none resident
- 183→ full year→test apply, at end of year, “have been in AUS for half of year→usual place of abode, at end of year→because all ties are broken→not resident for rest of 24 days, intend to take residency of AUS→no)
- focus on whole situation, not too focus on one specific
- share: none resident, CGT I1 deems disposal
- 2. (b) wages and tips: wage: 6-5, tips—ordinary income, personal exertion, why income: question is about in what capacity she received that money→as waitress, not be friendly.
- Horse: cases, winnings not, if not OI—go to CGT exemption 180, exclude into CGT, dividends— not shares itself, OI & SI 44, 6-5 from property, SI—prevail, anti-overlap rule, loss—capital A1, not G1—return from shares)