

## Table of Contents

<b>1) INCOME.....</b>	<b>2</b>
<b>2) ORDINARY INCOME – PERSONAL EXERTION .....</b>	<b>3</b>
<b>3) ORDINARY INCOME - BUSINESS .....</b>	Error! Bookmark not defined.
<b>4) FRINGE BENEFITS TAX.....</b>	Error! Bookmark not defined.
<b>5) CAPITAL GAINS .....</b>	Error! Bookmark not defined.
<b>6) RESIDENCE AND SOURCE .....</b>	Error! Bookmark not defined.
<b>7) DEDUCTIONS .....</b>	Error! Bookmark not defined.
<b>8) SPECIFIC DEDUCTIONS .....</b>	Error! Bookmark not defined.
<b>9) DEDUCTION LIMITATIONS .....</b>	Error! Bookmark not defined.
<b>10) CAPITAL ALLOWANCES .....</b>	Error! Bookmark not defined.
<b>11) PARTNERSHIPS .....</b>	Error! Bookmark not defined.
<b>12) TRUSTS .....</b>	Error! Bookmark not defined.
<b>13) TAX ADMINISTRATION .....</b>	Error! Bookmark not defined.
<b>14) Tax Avoidance .....</b>	Error! Bookmark not defined.

# 1) INCOME

## Introduction to Income

- A receipt must be classified for tax purposes.
- There are four classifications for tax purposes.
  - Ordinary income s6-5 ITAA97
  - Statutory income s6-10 ITAA97
  - Exempt Income s6-20
  - Non-Assessable Non-Exempt Income (NANE) s6-23

## More than one classification?

- A receipt can only have 1 classification of income: s6-1(5)
- If it fits in more than one classification how to resolve?
  - ITAA rules eg such as basic relationship rule s6-25
- S6-25 provides (unless contrary appears) the specific statutory income rules overrides the ordinary income rule
- Other rules include
  - s23L ITAA36 (for FBT) (see also s136 FBTAA)
    - Certain benefits in the nature of income not assessable
  - S15-2 ITAA97
    - Allowances and other things provided in respect of employment or services
  - 17-5 ITAA97
    - GST and increasing adjustments

## No Classification?

- If it is neither ordinary income nor statutory income it is NOT assessable income
- If it Exempt you do not pay income tax on it
- If it is NONE you (likely) pay another tax on it eg GST, FBT
- If it is NONE of these it is “not assessable” s6-15

## Taxable Income

- 4-15 ITAA 1997
  - Assessable income – Deductions = Taxable Income

## Assessable Income

- s6-1
  - Assessable income = Ordinary income (s6-5) + Statutory income (s6-10)

## 2) ORDINARY INCOME – PERSONAL EXERTION

### Ordinary Income

- 6-5 ITAA 1997
  - Income according to ordinary concepts
  - Note: s10-5 categories of statutory income that will not be considered ordinary income
    - Bold ones are from the 1936 act

### Three Categories of Ordinary Income

- Income from Personal services/exertion
  - Salary, wages, services
- Income from Business
  - Sale of goods, provision of service, manufacturing etc
- Income from property
  - 'Passive' income eg. rent, interest, royalties

### Pre-requisites for Ordinary income

- Cash or Cash Convertible
  - If a gain is cash or cash convertible it may be ordinary income
  - Cash or cash convertibles
    - Need to be readily convertibles to cash; eg. car, real estate, transferable holiday
    - If not, it is not ordinary income
      - **FCT v Cooke & Sherden**
        - Taxpayer, employee of a soft drink retailer received free holiday as an incentive by a soft drink manufacturer. Holiday could not be converted into cash as it was not transferable. Held couldn't be ordinary income as it couldn't be converted into cash
      - **Payne v FCT**
        - Frequent flyer points accumulated by the taxpayer travelling for work purposes that was paid by the employer. Held not income as they were not money and could not be converted into cash and were subject to cancellation if sold
        - Wouldn't be taxed under fringe benefit – TR 93/2
      - NOTE:
        - Both above cases would now be taxed as follows
          - Would not be taxed through s15-2 as the employer did not provide the benefits
          - Taxed under s21A – Non Cash Business Benefits
    - If it is illegal to sell a good, the receipt cannot be regarded as cash convertibles: **Payne v FCT (1996)**.
- Real Gain
  - Needs to be a genuine gain
  - If receipt is not genuine gain, then it generally will not be ordinary income
    - **Hochstrasser v Mayes (1960)**
      - Taxpayer's employer required him to move cities. Taxpayer sold his house in the city for less than the price he purchased it. Taxpayer's employer reimbursed him for the loss from selling his house. The House of Lord held that the payment was not assessable because it's not real gain but rather a compensation for work-related expense.
  - Gains from hobbies are not real gains

- If you aren't expecting to make a gain out of it it's not a real gain eg. you make crafts and someone sees it and wants to buy it
- If you are intentionally trying to sell it it is likely to be real gain
- Reimbursement – no gain because you paid for it in the first place
- Allowance constitutes ordinary income.

### **Characteristics of ordinary income (Indicative but not always present)**

- Regular/periodic Receipts
  - eg. Interest, rent, salary
  - More likely to be ordinary income than a gain that is paid as a lump sum
    - FCT v Dixon (1952)
      - Taxpayer received periodic payments from his former employer to supplement the difference from his wartime pay during WWII. Payments are classified as ordinary income
    - FCT v Blake (1984) and FCT v Harris (1980)
      - Identical facts except in FCT v Blake, the receipt was regular while in FCT v Harris the receipt was regarded as one-off.
      - Court held FCT v Blake – receipt was ordinary income, FCT v Harris – receipt was not ordinary income but capital.
  - Not essential however as there have been a number of cases where taxpayers have converted an income stream into a lump sum and unsuccessfully argued that such assignments are of a capital nature
    - FCT v Myer Emporium
      - Taxpayer assigned the right to receive interest income for a lump sum of \$45 million. HC held the taxpayer had merely converted future income into present income
    - Henry Jones (IXL) Ltd v FCT
      - Taxpayer assigned its rights to receive royalties to a finance company for \$7.6 million. FFC held that the \$7.6 million was income
    - Premier Automatic Ticket Issuers v FCT (1933)
      - A lump sum receipt was considered ordinary income because of interest received from loan agreement
    - Foley v Fletcher (1843-1860)
      - Regular receipt was not considered ordinary income because of instalments from sale of capital asset.
- Flow Concept
  - Fruit and tree concept:
    - Eg. Dividend is fruit/ordinary income and gain from selling shares is tree/capital
    - Rent payment is fruit/ordinary income and gain from selling house is tree/capital
  - Gain will have both related traits:
    - Nexus with an earning source. Specifically, nexus with one of following
      - Property: Page 172
        - Receipts relating to a capital asset (eg. selling property) generally do not constitute ordinary income
        - Common types of income from property
          - Rent
          - Dividends
          - Interest
          - Royalties
      - Business (profit)

- Personal Exertion/Services (salary)
- Being severable from earning source
  - Gain can be extracted without effecting underlying earning source

### Other Principles (Apply if applicable)

- Reliance
  - Keily v FCT (1983)
    - Government aged pension was ordinary income because it's regular, expected and depended upon by the taxpayer for support.
  - Anstis v FCT (2010)
    - Youth Allowance payments constituted ordinary income
  - FCT v Dixon (1952)
    - Employer offered his employees "top-up" payments if they enlisted during WWII. He said to them if they ceased working for him and signed up to be soldiers, he would pay them difference between former salary and military salary. Court decided "top-up" payment was ordinary income because they were regular, expected and depend upon by taxpayer for personal living expenses. Also the payment compensated for lost salary and the salary would have been ordinary income, so the payments themselves were ordinary income.
- Compensation
  - Takes on character of that being replaced
  - If it's for the loss of capacity to earn, then it is capital and not ordinary income
  - If it is replacing income, then it is ordinary income
  - Characteristics of capital – lump sum, not expecting it, and not connected to an income related activity
- Illegal receipts
  - Receipt from illegal activity does not prevent it being assessable:
  - Partridge v Mallandaine (1886)
  - La Rosa
  - Partridge v Malladine
- Constructive receipt:
  - s 6.5(4)
    - Income is treated as being derived by a person when that income has been dealt with as that person directs.
    - If someone is entitled to receive income but arranges for someone else to receive it then the person originally entitled to income has constructively received it and hence will be assessable on it.
      - A legislative "fix" for requirement to be a real gain
  - Note also:
    - Principle of Mutuality
    - Recreational clubs (no real gain) to members: *RACV v FCT* (refund of club membership fees not assessable)
- Principle of mutuality
  - No real gain if taxpayer makes payment to himself – therefore not ordinary income
    - *Bohemians Club v Acting FCT* (1918)
  - This type of receipt is non-assessable non-exempt income under s 6-23 ITAA 1997.
  - *RACV v FCT*
    - Refund of club membership fees not assessable

- However, fee from non-member, interest on investment, income from trading will not be subject to mutuality principle
  - *Carlisle & Silloth Golf Club v Smith* (1912).

## INCOME FROM PERSONAL SERVICE AND EMPLOYMENT

- 2 step approach
  - Identify activities undertaken
    - Eg. Labour, employment, services
  - Determine whether receipt is a reward for performing that particular activity
    - Salary, wages and commissions are directly connected with employment services provided and thus income:
      - *AG of British Columbia v Ostrum*
    - Even if a lump sum payment is made to retain or obtain services of a taxpayer, that payment will be income, as it is directly related to employment
    - Retention payment or a signing-on fee for a sportsperson is income
      - *Dean v FCT*
    - Receipts that are incidental to employment or services may also be income, and regard must be had to the facts of the case
    - If it is shown there is nexus between benefit and activity performed, it does not matter whether payment is received before, during or after completion of task:
      - *Hochstrasser v Mayes* (1960)
    - It is irrelevant whether benefit is provided by the entity for which task was performed or by unrelated third party:
      - *Kelly v FCT* (1985)
    - Unrelated third party's payment will be ordinary income for taxpayer if they are reward for services, unless they are personal gift
      - *Hayes v FCT* (1956)
    - It is irrelevant if the payment is regular or a lump sum
    - It is irrelevant whether payments are from ongoing regular employment contract or a one-off receipt contractually required to be paid for performance of a given task
      - *Brent v FCT* (1971)
        - \$10,000 paid to Ronald Biggs' wife for exclusive right to publish her story

## Common Issues with Employee Receipts

- Salary Sacrifice Arrangements
  - Income is only assessable in the year derived: s 6-5(2) ITAA 1997
  - If personal service income is never derived, it will never be assessable: Ruling TR 98/1
  - Employment income is not derived if directed through SSA made between employee and employer before payment is due
  - ATO accepts effective SSA if income diverted before it is earned: TR 2001/10
    - Usually sacrificed into superannuation, otherwise FBT issues arise
    - Ineffective SSA will be treated as income
- Restrictive Covenant Payments
  - Restrictive covenant is payment for agreeing (usually under a contract) to not do something or to give up something
  - Is it income or capital?
    - Depends on whether or not connected to current employment
      - *Higgs v Olivier*

- Capital (after employment)
  - *FCT v Woite*
    - \$10,000 payment not to play football with any other club except North Melbourne (Capital)
  - Dean
    - Agreement made by an employee to remain with an employer for a period of time in return for a lump sum of money would be directly connected with employment, and thus the payment would be income
- Capital Receipt or Personal Exertion Ordinary Income
  - Lump sum payments – capital or OI?
  - Issue is whether disposed of
    - A valuable right (capital) or
    - Is payment for service
      - *Brent v FCT*
    - Exploitation of personal skills in a commercial manner (TR 1999/17)
  - E.g payments for changes to employment rights may give rise to capital receipts
    - *Bennett v FCT*
  - Sign-on bonuses are capital
    - *Jarrold v Boustead*
  - Unless sign on bonuses are normal practice e.g. sportspersons
    - *Reuter v FC of T*
- Voluntary Payments (Gifts)
  - Unexpected payments when received as a reward for service will be ordinary income
    - e.g. Christmas bonus: *Laidler v Perry*
  - Tips are third party voluntary payments received by service providers made in response to the service so are ordinary income
    - Also often considered a recognized incident of certain professions e.g. waiters
  - A gift given for personal (rather than professional) characteristics are not ordinary income: *Scott v FCT*
    - Beware the voluntary payment that is a reward for service (*Brown*)
    - Motives of donors while relevant is less important than “hands of the recipient” (Scott)
      - Has recipient been remunerated already?
    - Regular payments are also likely to be ordinary income: *Blake*
- Prizes and Windfall Gains
  - Dependent on luck (distinguish from skill) are unlikely to be ordinary income (lacks nexus)
  - Where prizes are a recognized incident of profession ordinary income: *Kelly v FCT*
  - Question of fact and degree:
    - If more closely aligned with professional skill and systematic approach more likely to be income
    - If more closely aligned with luck more likely to be non-assessable windfall gain
- Non-Cash Payment
  - Receipts that are not convertible to cash are not ordinary income
    - *Tennant v Smith*
      - Yearly value of privilege of free residence not cash convertible
    - *FCT v Cooke & Sherden*
      - Non-convertible holiday
    - *Payne v FCT*
      - Frequent flyer reward points not money or moneys worth
  - If there is nexus to employment or service then [s15-2](#) will apply to make the amount assessable as statutory income

- May also be subject to FBT if employee (see also s 23L ITAA36)

## **STATUTORY INCOME**

- **Benefits relating to employment or services rendered: s15-2**
  - s6-5 ITAA 97 takes priority over s15-2
  - Taxes personal services income that is not ordinary income
  - Requires the following
    - There be an allowance, gratuity, compensation, benefit, bonus or premium” (not limited to cash or expected payments)
    - Be provided to the employee/service provider
      - See Payne – Frequent flyer points
    - Gain is in respect of or in relation to (directly or indirectly) employment or provision of service (nexus)
      - Smith v FCT: Study bonus paid by bank– it was only as an employee of the bank that the taxpayer qualified for the payment
  - Section 15-2 does not apply to ordinary income or fringe benefits (see s 23L ITAA36)
- **Return to Work Payments: s15-3**
  - Makes assessable any amounts used to induce taxpayer to return to work
  - If could also be ordinary income, s6-25 applies to ensure s15-3 will apply instead



