

Compensation for Loss of Capital Asset

Classification of a compensation payment in relation to capital assets depends on the extent of damage to the asset: whether the asset is permanently destroyed or merely temporarily disabled

Income

If temporary loss of capital asset (e.g. factory unusable for 2 weeks)

CASE: Ensign Shipping Co Ltd v IR Commissioner of Inland Revenue (1928)

Compensation paid in relation to an asset that has been rendered temporarily disabled will generally be considered income in nature

Capital

If permanent loss of capital asset (e.g. factory burns down)

CASE: Glenboig Union Fireclay Co Ltd v IR Commissioner of Inland Revenue

Facts:

Taxpayer mining company mined fireclay. Railway company had tracks over part of the land to be mined and as a result, the company cannot work parts of land.

Taxpayer was compensated on the basis of profit it had lost.

Held:

Despite the method calculation, compensation was capital in nature – because it resulted in the loss of capital asset (i.e. part of ability to mine the land)

CASE: Sydney Refractive Surgery Centre c FCT (2008)

Facts:

Taxpayer was in the business of performing laser eye surgery. A TV current affairs aired a story on this clinic that was found to be incorrect. The taxpayer successfully sued the station for defamation (i.e. compensation for loss of reputation). The compensation was calculated in terms of loss of profit.

Held:

Whilst the compensation was calculated by reference to loss of profit, it was nevertheless capital in nature. It was compensation for loss of reputation (i.e. injury to a capital asset... reputation is part of the capital)

Compensation for Loss of Trading Asset

Compensation for loss of trading stock = ordinary income s 6-5

If not, it is assessable as statutory income by s 70-115

Compensation by way of Insurance Proceeds

Statutory inclusion (s 15-30) –

Amounts received by way of insurance or indemnity are still assessable if the amount would have been included in assessable income but not ordinary income

Special rules for recovery of losses under insurance policies for livestock and timber (s 385-130) –

Broadly, insurance payout is included in assessable income in equal instalments over five years

Composite Claims

Where compensation contains capital and revenue (income) elements, its taxable nature will depend on whether these components can be separated.

UN-Dissected lump sum receipt:

1. Loss of income
2. Loss of capital or capital assets

CASE: McLaurin v FCT (1961)

If get compensation for BOTH loss of income and loss of capital in one lump sum payment, 2 possibilities:

1. All of compensation is capital; or
2. The portion of compensation that represents loss of income = income, rest is capital

Part of the lump sum will be assessable if:

- a. it is possible to clearly separate the payment into the capital and the income component, or
- b. there is some firm way of calculating two components

So...

- ✓ if you can clearly separate income and capital, or you can calculate it with some precision
 - then the income component of compensation will be deemed ordinary income
 - therefore assessable
- ✓ if you cannot do any of these
 - then the entire compensation payment is a capital receipt
 - non-assessable

Assessable Income...Summary...

Positive indicia – Income according to ordinary concepts	Negative indicia – Not “income according to ordinary concepts”
Earned Income – e.g. wages, bonuses, commissions, tips	Windfall gain – e.g. gifts, prizes (if no nexus between \$ and personal exertion), chance winnings
Benefit in the form of cash or convertible into cash	Non-cash benefit that is not convertible – e.g. frequent flyer points, free holiday
Regular or periodic in nature (not definitive)	Lump sum or once-off payment (not definitive)
Compensation for lost income	Compensation for capital loss
Earned from business activity	A hobby
A once-off business transaction with an intention to profit	Capital transaction
A gain or income arising from the use of capital items	The disposal / realisation of capital