

Tax Law Summary Notes –

W1 - (INTRO) WHAT IS A TAX **Error! Bookmark not defined.**

W2 - LIABILITY TO PAY INCOME TAX (TAXABLE ENTITIES + INTERNATIONAL ASPECTS) .. **Error! Bookmark not defined.**

W3 - CONCEPTS OF ORDINARY INCOME (Legislation: Sec 6-5 and Sec 15-2 of ITAA97).....3

W4 - (ORDINARY INCOME) INCOME FROM BUSINESS (Legislation: Sec 6-5 and Sec 15-2 of ITAA97). **Error! Bookmark not defined.**

W5 - EXTRAORDINARY & ISOLATED TRANSACTIONS (Legislation: Sec 6-5 and Sec 15-2 of ITAA97) . **Error! Bookmark not defined.**

W6 - CAPITAL GAINS TAX – Statutory (Legislation: Sec 102-5)..... **Error! Bookmark not defined.**

W7+8 – GENERAL DEDUCTIONS and APPLICATION OF DEDUCTIONS (Legislation: Sec 8-1).....**Error! Bookmark not defined.**

W9 – SPECIFIC DEDUCTIONS AND CAPITAL ALLOWANCES (Legislation: Sec 8-5)..... **Error! Bookmark not defined.**

W10 – GOODS AND SERVICES TAX (Legislation: GST Act (A New Tax System) 1999)... **Error! Bookmark not defined.**

W11 – FRINGE BENEFITS TAX (FBT) (Legislation: Fringe Benefits Tax Assessment Act 1986 (FBTAA)) **Error! Bookmark not defined.**

Is the taxpayer a resident of Australia?

Individual	Business
<p>4 Tests of Residence:</p> <p>1) Ordinary Concepts of residence: - Resides – “to dwell permanently or for a considerable time” - Factors to include: Miller v FCT 1946</p> <ul style="list-style-type: none"> • Time spent in Aus • Frequency, regularity and duration of visits <ul style="list-style-type: none"> - IRC v Lysaght 1928 • Purpose of Visits • The maintenance of a place of abode in Australia for use • Family, social and business ties <ul style="list-style-type: none"> - Levene v IRC 1928 • Nationality <p>2) Domicile: - If an individual’s domicile is Australia, they are a resident unless the commissioner is satisfied that the person has a permanent place of abode outside Aus. Both domicile at origin of birth, and domicile of choice (where the taxpayer intends to make their home indefinitely)</p> <p>FCT v Applegate 1979 – Permanent place of abode – objective each year IRC v Levene & Lysaght – Abode and dwelling Factors: Intended and actual stay overseas. Location of established home. Intentions. Duration and continuity of taxpayer’s presence</p> <p>3) 183 Day Test: - An individual’s residence is Australia if physically present for more than ½ and income year. Unless:</p> <ul style="list-style-type: none"> • The individual’s usual place of abode is outside Australia • The individual does not intend to take up residence in Aus <p>4) Superannuation Test Only applies to members of super funds for Commonwealth Government employees</p> <ul style="list-style-type: none"> • Diplomats in a foreign currency • Foreign ministers 	<p>3 tests of Residence:</p> <p>1) Place of incorporation test - Automatically Australian resident if incorporated in Australia under the Corporation Act 2001</p> <ul style="list-style-type: none"> • Regardless of any other factors <p>2) Central Management and Control</p> <ol style="list-style-type: none"> 1. <u>The company must carry on business in Australia</u> Tax ruling 2004/15 Commissioner <ul style="list-style-type: none"> - For operational activities – it is where the activities take place - For passive dealings – it is where the decisions are made 2. <u>The company’s central management and control must be in Australia</u> <p>Where is the “real control”</p> <ul style="list-style-type: none"> - Where actual high level decisions are made/developed - Where monitoring of overall corporate performance occurs <ul style="list-style-type: none"> - Malayan Shipping v FCT 1946 <p>Day to day control of the business operations does not amount to central management and control of the company.</p> <ul style="list-style-type: none"> - Koitaki Para Rubber v FCT 1940 <p>3) Voting control test</p> <ol style="list-style-type: none"> 1. Where voting power is controlled by shareholders who are residents of Australia (more than 50% of voting power) 2. The company is carrying on business in Australia

Ordinary income is "income according to ordinary concepts" and is assessable under the **s6-5 Income Tax Assessment Act 1997**
 "Income according to ordinary concepts"

- Gains require characterization by courts to determine if the gain has income character
- E.g. **Jordan CJ in Scott V Commissioner of Taxation 1935** interpreted income to be determined "in accordance with the ordinary concepts and usages of mankind"

Prerequisites of ordinary income. A receipt cannot be ordinary income unless it fulfills **both** prerequisites:



NOTE: the prerequisites gives precedents to ordinary income, it is not itself sufficient for the gain to be ordinary income

1. Cash or Convertible to Cash	2. Real Gain to the Taxpayer
<ul style="list-style-type: none"> • A gain cannot be ordinary income it is NOT CASH or not CASH CONVERTIBLE e.g. Tennant V Smith 1892 → Bank gave him a free house to work at the bank → cannot rent out → NOT ORDINARY income • What is CASH CONVERTIBLE <ul style="list-style-type: none"> ○ Item must be readily converted to cash ○ Must not be illegal to sell the goods Payne V FCT ○ Statutory overrides provision: s21A ITAA36 and s15-2 	<ul style="list-style-type: none"> • If a receipt is not a genuine gain, it is not ORDINARY INCOME • Benefits that saves a taxpayer from incurring expenditure is NOT ordinary income <p>Characteristics of a Gain</p> <ul style="list-style-type: none"> - Central issue in application of the Australian income Tax Legislation is the characteristic of the gain <pre> graph TD Gain[Gain] --> OrdinaryIncome[Ordinary Income] Gain --> Capital[Capital] Gain --> NotCapital[Not capital or ordinary Income] </pre>

Characteristics of Ordinary Income

- Provided both prerequisites of income are satisfied, a gain will be ORDINARY income if it shows sufficient characteristics:
 1. **Regular/Periodic receipts OR**
 2. **The Flow Concept**

NOTE: The ^ characteristics are only indicia as to what constitutes as ordinary income → courts can widen their views to reflect modern day practices: **FCT V Myer Emporium 1987**

1. Regular/Periodic Receipts	2. The Flow Concepts (Tree = Capital → Fruits = Income)
<ul style="list-style-type: none"> • Receipts that are <i>regular, expected</i> and <i>depended upon</i> for support can constitute ORDINARY INCOME, even if they do not flow from an earnings source: <ul style="list-style-type: none"> ○ Government aged pension Keily V FCT (periodic there fore is ASSESSABLE INCOME) ○ "Top up" payments: FCT V Dixon War patron → Flow test got him ○ Anstis v FCT 2010 	<ul style="list-style-type: none"> • For a gain to be considered ORDINARY income where it is likened to the fruit from the tree. It will have the following two related traits: <ul style="list-style-type: none"> • A connection (Nexus) with the earning source <ol style="list-style-type: none"> 1. Income from Property (E.g. rent has a nexus from property) 2. Income from Business (E.g. an accounting firm's profit has a clear nexus with business) 3. Income from Personal Services and Employment (e.g. salary has a clear nexus with an employee providing services.) 4. Can be removed (Severable) from its earning source


Other General Principles of income

- Compensation takes on the character of the loss being compensated (Car-Not Ordinary V Income - Ordinary)
- Legality of receipt does not affect their assessability **FCT V Las Rosa 2003** (Selling Drugs)
- Whether a receipt is ordinary income is to be characterized in the taxpayer's hands **Federal Coke Co Pty Ltd VFCT 1977**
- Constructive receipt rule: Entitlement to receive income VS gain being directed to someone else
- Mutuality – If a taxpayer makes a payment to him/herself, there is no gain and no income → Refund of fees from club membership **Bohemians Club v FCT 1918**

Exempt Income

- Not included in ASSESSABLE INCOME
- E.g. First Class: Charities, Second Class PHD Scholarship, Third Class: Army

PREREQUISITES OF ORDINARY INCOME	
Cash/Cash Convertible	
Tennant V Smith (1892) (Receipt from Free Accommodation Not Ordinary): Non Cash/Cash Convertible	Taxpayer = agent for a bank & lived in free accommodation supplied by bank <ul style="list-style-type: none"> • Conditions: Taxpayer was not allowed to sublet the accommodation • Court: Accommodation was not regarded as income (not cash/cash convertible)
FCT V Cooke and Sherden (1980) (Non cash convertible Holiday Not Ordinary): Non Cash/Cash Convertible	Taxpayer = Sold drinks "door to door" <ul style="list-style-type: none"> • Conditions: Receives a FREE holiday from the manufacturer if they sell a certain number of drinks, Holiday was NON TRANSFERABLE cannot be sold. • Court: Holiday were not cash cannot be sold = not ordinary (not cash/cash convertible)
Real Gain	

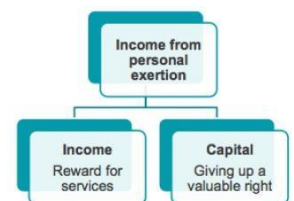
<p>Hochstrasser V Mayes (1960) (Reimbursement for work related loss upon moving premises Not Ordinary): Real Gain</p>	<p>Taxpayer = Employer requires him to relocate, taxpayer sold house he is relocating from</p> <ul style="list-style-type: none"> ● Conditions: Taxpayer sold house for less than purchase price, employer reimburses him for the losses of selling his house ● Court: Payment is NOT assessable → not a real gain because the taxpayer had been compensated for a work-related expense <ul style="list-style-type: none"> ○ If taxpayer is compensated for a non-work related loss = real gain = assessable income.
<p>CHARACTERISTICS OF ORDINARY INCOME - Regular/Periodical Receipts</p>	
<p>Keily V FCT (1938) (Aged Pension=Ordinary): Regular</p>	<p>Taxpayer = pensioner</p> <ul style="list-style-type: none"> ● Conditions: Received pension funds from the government ● Court: Considered ordinary because <i>regular, expected and depended</i> upon by the taxpayer for support
<p>FCT V Dixon (1952) (Top-up pay=Ordinary): Regular</p>	<p>Taxpayer = joined the army therefore cannot perform ordinary work</p> <ul style="list-style-type: none"> ● Conditions: Taxpayer receives top-ups from employer ● Court: Considered ordinary because <i>regular, expected and depended</i> upon by the taxpayer for personal living expenses <ul style="list-style-type: none"> ○ Payments are compensation under the compensation principle → compensation for salary earned → therefore ordinary (loss compensated for)
<p>Flow Concept</p>	
<p>Federal Coke Co Pty Ltd V FCT (ATO loses because did not use the principle of constructive receipts = Not Ordinary): Flow Missing</p>	<p>Taxpayer = subsidiary company asked to pay compensation to another subsidiary company.</p> <ul style="list-style-type: none"> ● Conditions: Received compensation payments but made to subsidiary company instead of company being compensated for ● Court: Receipt was not compensation, lack of dealings between Le Nickel and Federal Coke therefore could not be argued that the receipt was ordinary due to being the product of business activities
<p>RACV V FCT (1973) (Mutual receipts of a club)</p>	<p>Taxpayer = membership based club that provides a number of services to their customers</p> <ul style="list-style-type: none"> ● Conditions: Offer services to clients e.g. vehicle testing, driving lessons, referrals etc. ● Court: Issue: whether the services made were provided to members only or part of trading activities. <ul style="list-style-type: none"> ○ Towing services, vehicle testing, journal and travel expenses are mutual ○ Advertising, financial and insurance services and driving lessons are non-members and non-mutual
<p>Flow concept revisited Recall the "tree" and "fruit" where income = fruit flows from capital = tree → In the context of income from property</p>	
<p>Rent (ORD)</p>	<ul style="list-style-type: none"> ● Rent is a payment by one party in exchange for the use of the other party's property for an agreed amount of time. ● Receipt of rent constitutes ORDINARY INCOME: Adelaide Fruit and Produce Exchange Co V FCT (1932) <ul style="list-style-type: none"> ○ Even if received lump sum = still ORDINARY INCOME
<p>Interest (ORD)</p>	<ul style="list-style-type: none"> ● Interest is the return that flows from the lending of money and is the compensation for the loss of use of that money <ul style="list-style-type: none"> ○ Capital sum lent is not affected by the payment of interest Riches v Westminster Bank 1947 ○ Sometimes disguised through discounts and premiums Lomax v Peter Dixon ○ Constitute as ORDINARY income s6-5
<p>Dividends (STAT s6(1))</p>	<ul style="list-style-type: none"> ● Definition of "dividend" includes s6(1) ITAA36 <ul style="list-style-type: none"> ○ Any distribution in the form of money or property that a company makes to its shareholders ○ Any amount credited by the company to any of its shareholders as shares ○ A resident shareholder may be subjected to dividend imputation 
<p>Royalties</p>	<ul style="list-style-type: none"> ● A royalty payment is a payment that is calculated based on the usage of intellectual property or quantity/value of a substance taken McCaughey V FCT (1994) <ul style="list-style-type: none"> ○ Section 15-20 deems royalties to be assessable as statutory income, except where royalties constitute ordinary income
<p>Annuities</p>	<ul style="list-style-type: none"> ● Stream of payments on a regular interval. Perpetuities or fixed term <ul style="list-style-type: none"> ○ Full amount of the regular annuity is treated as ordinary income Egerton-Warboton v DCT 1934 ○ Certain annuities are subject to S27H ITAA36 which makes the annuity return capital component tax free ○ Account based pensions from super funds are usually taxed concessionally (often free) s307-70 ITAA97

INCOME FROM PERSONAL SERVICES AND EMPLOYMENT

- Receipts from employment/personal service = INCOME TAX or FBT
- Ordinary Income (**Sec 6-5 ITAA97**)
- Allowances and other things provided in respect of employment or services (**Sec 15-2**)

Income from Personal Exertion: Rewards from services Nexus

- A connection with a receipt resulting from a taxpayer's personal service constitute ordinary income: Wages (Clear nexus = Ordinary Income) → Gifts (No nexus = not ORD)
- Courts have used a 2 step approach to determine if an amount is ordinary income from personal services:
 1. **Identification** of the activity undertaken and
 2. Determining whether the receipt is a **reward for performing** that particular activity



ORDINARY INCOME AS A REWARD FOR NEXUS (determined by the courts)	
<u>Clearly Established (ORD)</u>	<ul style="list-style-type: none"> • Salary and Wages e.g. Brent V FCT 1971 Taxpayer was wife of a famous criminal → Sold story Payment is ordinary income from provision of personal services assessable under s6-5(1) • Fees charged for services rendered • Ancillary payments that are an <i>incident of labor</i>
<u>Non-Cash Benefit (ORD/s15-2)</u>	<ul style="list-style-type: none"> • A non cash payment may have nexus with personal exertion BUT ORDINARY = CONVERTIBLE to cash • E.g. Payne V FCT Frequent Flyer pts = not convertible to cash → can be assessable under s15-2 or FBT NOT s15-2 = third requirement not satisfied (in respect of....employment) Pts = 3rd party
<u>Uncertain (ORD)</u>	<p><u>Voluntary Payments</u></p> <ul style="list-style-type: none"> • Unexpected/voluntary payments received in an incidence of employment = (Ordinary Income) Calvert v Wainwright tip money as a taxi driver (would not have this if didn't work) • Possible characteristics of ordinary income based on the nature of payment FCT vDixon (Enlisted into the army → old employer paid difference → flow test got him) <p><u>Prize</u></p> <ul style="list-style-type: none"> • Price and chance winnings non-assessable if the gain is <u>luck</u> Kelly V FCT 1985 → AFL best and fairest • Ordinary Income will depend on degree of <u>personal exertion</u> and <u>luck</u> Case 37 – Game show Luck
Former Employee and Gifts	
<u>Gifts (ORD)</u>	<ul style="list-style-type: none"> • For <u>personal qualities</u> is NOT regarded as ORDINARY INCOME • For <u>ability to work</u> or <u>employment contract</u> is ORDINARY INCOME <p>Scott V FCT Importance of <u>personal relationship</u> b/n parties. "Money" = not for service = NOT ORDINARY</p>
STATUTORY INCOME FROM SERVICES AND EMPLOYMENT (determined by government)	
<u>Restricted Covenant (CGT)</u>	<ul style="list-style-type: none"> • Can be (1) on entering a contract, (2) During the contract's operations or (3) On conclusion of contract • Ordinary income = if connected with current employment (future services) Reuter V FCT(1993) • Capital Gains Tax <ul style="list-style-type: none"> - Separate agreement to give up valuable right: Higgs V Olivier 1952 (Famous Actor → paid not to act) or FCT V Woite 1982 (Famous AFL Player) - No connection with earnings activity Hepples V FCT 1991 (Paid not to work for competitor after retirement)
<u>Relinquishing Rights (CGT)</u>	<ul style="list-style-type: none"> • A <u>gain</u> from a change to entitlement under employment/service contracts takes the character of what it replaces • E.g. Bennet V FCT 1947 Rights to control a company as Managing Director → company compensate him → assessable under CGT
<u>Sign on Fees (ORD)</u>	<ul style="list-style-type: none"> • Sign on fees = attracting new people for new employment contracts = payment for future services = Ordinary Income Pickford V FCT 1998
<u>Services and Employment (s15-2)</u>	<ul style="list-style-type: none"> • Provision to bring GAINS from LABOUR into ASSESSABLE INCOME (broad provision that brings the value of certain gains from labour into assessable income) • Applies when the following 3 Requirements are satisfied <ol style="list-style-type: none"> 1. There is an Allowance, Gratitude, Compensation, Benefit, Bonus or Premium 2. Provided to the taxpayer 3. Connection with employment or service provided <p>Will not apply when 1. Assessable under s6-5 2. The gain is a fringe benefit</p> <p>In MONEY or any other form → if GIFT not caught under anything (no connection) Relationship with other tax provisions S15-2 will not appear if gain is FBT s23L(1) or ORDINARY INCOME s6-5</p>

Derivation of Income:

Timing differences between accounting tax and financial accounting – Recognition of income “when is a gain ‘derived’” or “when is a loss outgoing?”

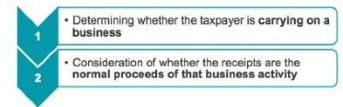
- Cash basis is suggested for sole practitioners and small businesses. **Carden, Firstenberg, Henderson**
- Large firms may switch between, as business grows. **Henderson v FCT 1970**
- Layby: Moneys in adjustment before goods and services are supplied, does not constitute income **Arthur Murray v FCT – Prepaid dance lessons were not derived until provided**
- Dividends are derived when they have been paid (cash or through reinvestment **Brookton Co Op Society v FCT 1981**)
- Delays because of a dispute – for taxpayers that:
 - Account on accruals basis and are owed money at the end of the income year that has not yet been paid due to a bona fide dispute
- The disputed amount is not derived in the year when the goods or services were sold/provided **BHP v FCT 2002**

CASE SUMMARIES - INCOME FROM PERSONAL SERVICES & EMPLOYMENT - Ordinary Income as a reward for Nexus	
Brown V FCT (2002) (Property received as a reward for service = Ordinary): Reward for Services	Taxpayer = Mr. Brown <ul style="list-style-type: none"> Conditions: Receives free property from a property developer → all costs of paid for → total value 1m → brown plays a role in the success of the business Court: Brown argued that it was a personal gift → didn't have nexus with worked performed or service provided. BUT Commissioner → benefit was a result of services rendered by Brown. Full Federal Court → benefits received = ordinary income because the benefit received was from activities undertaken by Brown. Nexus = reward would only be forthcoming if the deal was finished
FCT V Harris (1980) (Payments to retired employee = Ord): Reward for Pension	Taxpayer = retired bank employee <ul style="list-style-type: none"> Conditions: One-off payment of \$50 from the bank = pension top-up to counter the effects of increasing inflation Court: Not a product of past employment = not ordinary, although he would not have received the payment if he hadn't work at the bank → the payment is related to his pension and therefore not a product of his employment.
Laidler V Perry (1965)	Taxpayer = Employee
Scott V FCT (1966) Haynes V FCT (1956) (Personal Gifts = Not Ordinary): Reward for Personal	Scott = Taxpayer = solicitor <ul style="list-style-type: none"> Conditions: Acted as a solicitor for Freestone for sometime – Freestone gives Scott a gift in money Courts: the extent of personal relationship will determine if gift is ordinary or not. Personal gift = from personal relationship = not ordinary Haynes = taxpayer = director of a company Conditions: Gave shares to company buying out <ul style="list-style-type: none"> Courts: Not ordinary = value of shares transferred to Hayes = not ordinary = personal relationship there.
Kelly V FCT (1985) (Professional sportsperson's prize = Ordinary) Prize Money (from 3rd party)	Taxpayer = Plays football in WA - Conditions: Won best and fairest award <ul style="list-style-type: none"> Courts: Prize money = ordinary income even though it was unexpected and paid by an unrelated third party <ul style="list-style-type: none"> Was eligible because he was a member of the club He was awarded the prize because of his skills and abilities
Payne V FCT (1996) (Frequent flyer points = not Ordinary) Non-cash benefit (from 3rd party)	Taxpayer = Payne works at a large accounting firm <ul style="list-style-type: none"> Condition: travels frequently for business purposes = work pays, frequent flyer points accumulated Courts: FF Pts = generated through work travel = not ordinary, tickets were not money or monies worth → can only be used by the program member → cannot be sold (NO NEXUS)
Capital Receipts	
Brent V FCT (1971) (Payment for services of giving up valuable rights = Ordinary) Personal exertion	Taxpayer = Mrs Brent wife of infamous criminal member of the gang in the UK "Great Train Rob" <ul style="list-style-type: none"> Conditions: Approached by numerous newspapers with offers to sell her story → eventually signed an agreement with <i>Daily Telegraph</i> exclusive rights Courts: Earnings were ordinary income, she was paid for her services of telling her story → the service of telling her story, nothing was given up → cannot be capital "Exclusive Rights" to her interview → other authors can get info elsewhere
Bennett V FCT (1847) (Relinquishing Employment rights = Capital) Changing to entitlements	<ul style="list-style-type: none"> Conditions: Original contract terminated, new contract was appointed but relinquished certain rights. → Compensation made for the loss in 3 payments from the company Courts: Payment was not for loss of income → capital in nature for removal of rights that Bennett originally had. Giving up rights to control the company
Higgs V Olivier (1952) Cap Hepples V FCT (1991) Cap VS Reuter V FCT (1993) Ord Restricted Covenant	Separate agreement to give up valuable right: Higgs V Olivier (Famous Actor → paid not to act) No connection with earnings activity Hepples V FCT 1991 (Paid not to work for competitor after retirement) Reuter V FCT (1993) → Taxpayer was involved in a famous takeover → arrangement (Paid \$8m) : he will not without prior approval, claim the success fee (payment for the takeover) → Receipt of \$8m was closely connected to service provide by taxpayer = ordinary income
FCT V Woite (1982) (Restricted covenant on entering a contract = Capital)	Taxpayer = footballer played for South Australian team <ul style="list-style-type: none"> Conditions: Received \$10 000 not to play for anyone else Courts: \$10k was capital and was not ordinary from his ordinary profession and ability to play football
Jarrold V Boustead (1963) = Capital Pickford V FCT (1998) = Ordinary Sign on fees	Jarrold = amateur rugby player paid a sign on fee 3,000 pounds to give up his amateur status to professional → receipt was held to be capital in nature as it was a payment for giving up the rights to play rather than payment for future services Pickford = Offered a salary package to take up employment with another firm, once off payment → this is ordinary because it was an incident of the taxpayer's income-earning activities and employment
Statutory Income from services and employment	
Smith V FCT (1987) (Study incentive scheme = 15-2 Stat) Service & Employment	Taxpayer = Smith employee at Westpac <ul style="list-style-type: none"> Consideration: An employee who undertook approved study and received money under this scheme Courts: Nexus: no sufficient nexus with employment. Scheme exists to increase employee productivity, Smith was eligible for the scheme by being employed = 15-2
FCT V Inkster (1989) (Compensation payments = 15-2 Stat) Compensation Receipts	Taxpayer = ex-employer resigned due to health reasons incurred during previous employment <ul style="list-style-type: none"> Consideration: compensation payment was for taxpayer's loss of earning ability rather than loss of earnings Courts: compensation was mandatory fall under 15-2 as it is a compensation payment for LOSS of EARNING ABILITY
Reseck V FCT (1975) McIntosh V FCT (1979) 15-2	Reseck = Consequences for termination of employment McIntosh = conversion of pension entitlement to lump sum "in consequence" of termination

- Gains arising from carrying on a business constitute as ordinary income (s6-5)
 - E.g. sporting goods store → sell sporting goods → ordinary income
- Gains from non-business activities (e.g. hobby) is not assessable income UNLESS,
 - Another general concept of ordinary income applies (e.g. extraordinary & isolated transactions – selling entire business **MYER CASE**) or
 - **s21A**: Specifically made assessable by legislation (i.e. statutory income)

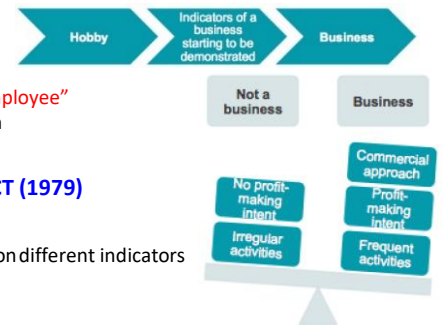
Receipts from Business Activities

Characterizing receipts as ordinary income from a business activity involves a two-step process (**MUST SATISFY BOTH!**)



1. Carrying on a business

- Determine when a hobby or recreational activity becomes a business:
 - Legislative definition of a “business” **s995-1**:
 - **“includes any profession, trade, employment, vocation or calling, but does not include occupation as an employee”**
- it is necessary to ascertain the ordinary meaning of the word “business” due to broadness of legislative definition



Indicators of a Business Activity

- Courts use various indicators/characteristics that indicate the presence of a business e.g. **Ferguson V FCT (1979)**
- Not one characteristics along can be used to decisive factor, but a question of FACT and DEGREE
- Imprecise distinction between hobby/business – no exact formula. Varying degree of importance placed on different indicators depending on type of activity

Common Business Indicators (considered by the courts)

- Profit making intention
 - Not necessary to show actual profits to show INTENT
 - Lack of profit-making intention doesn't preclude there being a business **Stone V FCT (2005)** → javelin & policewomen already **s6-5** but sponsors/endorsement makes it ordinary
- Scale of activity
 - Nature and type of CAPITAL and LEVEL of turnover **FCT V JR Walker (1985)** goats
 - → E.g. The larger the business turn over the more likely it would held to be a business, but this does not exclude small activities from being held to be a business
- Commercial approach **[Big one]**
 - Whether activities undertaken are **RECREATIONAL Thomas V FCT (1972)**
 - → e.g. Whether professional advice has been sought before and during operation/Markets for produce been explored/produce more than needed for domestic purposes
- System and organization employed
 - Degree of PLANNING and amount of TIME invested
 - Taxpayer may delegate these duties and still be considered a business: **Ferguson V FCT (1979)**
- Methods characteristics of the particular line of business
 - Business practices consistent with industry
 - E.g. Dairy farmer using planned breeding programs to increase milk production
- Sustained and frequent activity
 - Output much greater than what needed for domestic purposes: **Thomas V FCT (1972)** drugs

Hobby or Business?

Gambling: Professional bookmakers and casino operators carry on a gambling business (scale, commerciality and profit intention)

- Individuals who gamble are very unlikely to be considered by the courts, unless a significant degree of indicators exist:
 - WAS a gambling business: **Trautwin v FCT (1936)**
 - NOT a business: **Evans v FCT (1989)**

Sportspeople: Courts have tended to more likely label professional sportspeople as being in business. Important to determine whether receipts derived by a professional sportsperson is from a business or personal service.

- An employee has limited deductions compared to a business
- Olympian (also a full-time police officer) derived among other things: prize money, sponsorship and appearance fees. No clear profit motive: **Stone v FCT (2005)**.
- Playing football full-time, sports managers (representatives), ancillary activities such as endorsements and media arrangements: **Spriggs v FCT; Riddell v FCT (2009)**.

Investments: A business of investment can exist where there are sufficient indicators of a business

- Investment Business: **London Australia Investment Co Ltd V FCT (1977)** high degree of investing and re- investing in shares to maintain a high degree of dividend yield
- Not a business: **AGC (Investments) Ltd V FCT (1992)**: invests for the long-term growth, rather than speculative investment

Tax consequences: If a business, the investment (e.g. shares) will be treated as trading stock and hence on a REVENUE ACCOUNT
 If not a business: the investment is on a CAPITAL ACCOUNT

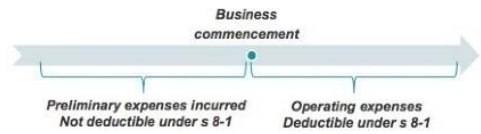
Land Sales: Difficult to draw a clear line as to when the proceeds from sale of land is income or capital

- **Income:** **FCT v St Huberts Island (in liq) (1978)** Taxpayers primary activity is purchasing developing and selling the land
- **Capital:** Where the taxpayer is not in the business of land sales or development

Note, notwithstanding a prima facie capital characterization, activities of land development could constitute an extraordinary or isolated transaction.

Commencement of a Business

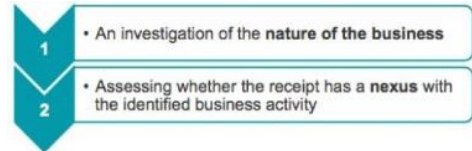
- It is necessary to identify the time when the business commences
- Preliminary = Haven't generated nexus
 Operating = have incurred expenses only on revenue account & revenue character
- Ascertaining time of commencement of a business is a question of FACT: **Pulp and Paper Ltd v FCT (1976)**



Must follow the following

1. **Committed** → Not committed to the business
2. Purpose/Intention → Have not started the business

Nexus (income) → Have not gained income



2. Normal proceeds of a business

- Receipt from normal proceeds of a business constitutes ordinary income (s6-5)
 - Must show connection (shoe shop → sells shoes)
 - Or EXCEPTION: if receipt is not under ordinary course of business s21A third party
- Characterizing a receipt as part of normal proceeds of the **business requires:** ^

If receipt is not within NORMAL PROCEEDS it may be ordinary income in statutory income.

Part 1: Nature of the Business

- A broad and narrow view of the business activities determines if a receipts arise from normal proceeds

Broad (More Common):

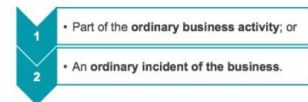
- More likely than unusual receipts could still be business income
- E.g. Company pays construction contracts but pays in instalments and not lump sum = NORMAL
- **GP International Pipecoaters v FCT (1990)**

Narrow

- Less likely than unusual receipts will be normal proceeds of the business **FCT v Merv Brown Pty Ltd**

Part 2: Nexus of receipt with Business

- Receipt constitutes normal business proceeds when it is derived as: →
- In relation to (2) the FREQUENCY and magnitude of the activity is an important consideration



Regular sale of ex-leased equipment in a leasing of equipment business **Memorex Pty Ltd**

Sale/lease of comp equipment → lose legal entitlement therefore would be normal business = ordinary business activity

Not regular = Sale of import quotas **FCT v Merv Brown Pty Ltd**

Normal Proceeds: Non-Cash Business Benefits

- Prerequisites of ordinary income:
- Ordinary income does not include receipts that are NOT cash or convertible to cash **FCT v Cooke and Sherden (1980)** Overseas trip = bonus
- Section **21A** enacts to *deem non-cash business benefits as being convertible to cash* (at its arm's length value = market value) :
 - The gain will be assessable as ordinary income provided it arises from a business and satisfies nexus requirement
- **S32-5** in relation to entertainment expenses always exempted

S21A if it is less than \$300 then exempted



Case Summaries

<p>FCT V JR Walker (1985)</p> <p>(Small scale goat-breeding = Business):</p> <p>Indicators of a business: Scale</p>	<p>Taxpayer = real estate agent who is interested in breeding Angora goats Goes off and buy 1 goat</p> <ul style="list-style-type: none"> Intention: Breeding the goat (intent from a commercial perspective) (1) how he would make his profits (Profit making intention) Breeding processed he involved assistance from a Vet → Professional <ul style="list-style-type: none"> Business Projections + Records Repetition and regularity in breeding activities in that this process was undertaken repeatedly for a number of years (Shows small scale to large scale in the future) (2) Court: you have a business which can be developed into a larger Is business like = keeping accounts, joining the Angora Breeding Society, reading journals & keeping him informed.
<p>Thomas V FCT (1972)</p> <p>(Hobbies VS Business = Business):</p> <p>Indicators of a business: Scale</p>	<p>Taxpayer = Barrister purchased land where he constructed a private home Purchase of land where he planted several varieties of trees and there was a home built on the land (personal home).</p> <ul style="list-style-type: none"> Intention: TIPPING POINT: He planted trees for produce to get an income out of it <ul style="list-style-type: none"> Why did he decide to plant the trees → He realizes that the land is fertile(1) Scale was larger than domestic needs (therefore this is a business) Court: Will evidence that planting trees would be a profit intention as it is the action of the tax player
<p>Ferguson V FCT (1979)</p> <p>(Indicators of a Business = Business):</p> <p>Existence of a business: Profit, Regular</p>	<p>Taxpayer = Navy Officer</p> <ul style="list-style-type: none"> Intention Taxpayer (Ferguson) planned to purchase rural land → intended to establish a full-scale cattle production for retirement in 2/3 years → leased cattle's & Bred Taxpayer contended that these activities constituted a business but commissioner argued that this was only preparation for future business Court held Ferguson was "carrying on a business" even though it was (1) small (2) preliminary to his intended future business <ul style="list-style-type: none"> Purpose of profit – making may be important but not essential Repetition and regularity is a consideration, but a business could involve a single transaction → every business must commence with a single transaction Organization and businesslike approach with appropriate record keeping etc. = indication of business Having other source of income did not prevent activity from being a business Size of operation/Capital are relevant but must look in context of the type of activity <p>These activities were more than preparation to begin a future business</p>
<p>Trautwein v FCT (1936)</p> <p>(Hobbies VS Business): Gambling</p> <p>Evans v FCT (1989)</p>	<p>Professional Gambler, breeds horses and placed large bets related to his breeding activities</p> <ul style="list-style-type: none"> Court held: In isolation, not normally ord income. HOWEVER, his relationship to the industry, his information collecting and frequency of bets (and size) were part of his comprehensive horse racing business <p>High volume gambler on horse racing, FCT tried to claim he was carrying on a professional business</p> <ul style="list-style-type: none"> Because of tote betting rather than F/O, and never using computer software to calculate best odds, Evans was just in love with betting. He bet on trifectas and low odds too and not assessable as carrying a business
<p>Stone V FCT (2005)</p> <p>(Hobbies VS Business): Sportspeople: Springgs v FCT Riddell v FCT</p>	<p>Athlete plays javelin and is a police → as an athlete she receives grants and also sponsorships</p> <ul style="list-style-type: none"> Intention: Tipping point: Sponsorship that was when the "profit motive" started Court: A Business! Because sporting activities that all cash receipts from this business were ordinary income s6-5 <ul style="list-style-type: none"> Lacked profit motive Examination of motives (entered in sponsorship deals) = indicator of a business
<p>FCT St Huberts Island Pty (in liq) (1978)</p> <p>(Hobbies VS Business): Land sales</p>	<p>Primary objective of the taxpayer was to develop and resell the land at a profit.</p> <ul style="list-style-type: none"> Court held: Land could form part of trading stock and the definition of trading stock is not restricted to s6 ITAA36
<p>La Rosa</p>	<p>- Selling illegal drugs</p>
<p>Case for STEP 2: NORMAL PROCEEDS OF A BUSINESS</p>	
<p>FCT V Merv Brown Pty Ltd (1985)</p> <p>Sale of unwanted import quotas = not proceeds of business = Capital</p> <p>Narrow Approach</p>	<p>Taxpayer = clothing importer</p> <ul style="list-style-type: none"> Intention: sell import quotas for these less profitable items → quota sold only represent a small number of import quotas held by taxpayer Courts: <ul style="list-style-type: none"> Sale of quota = Capital Nature and not normal proceeds of the business The sale of import quotas were not normal proceeds of this business activity → sales were a reorganization of taxpayers' business as a result of changes to govt. policy