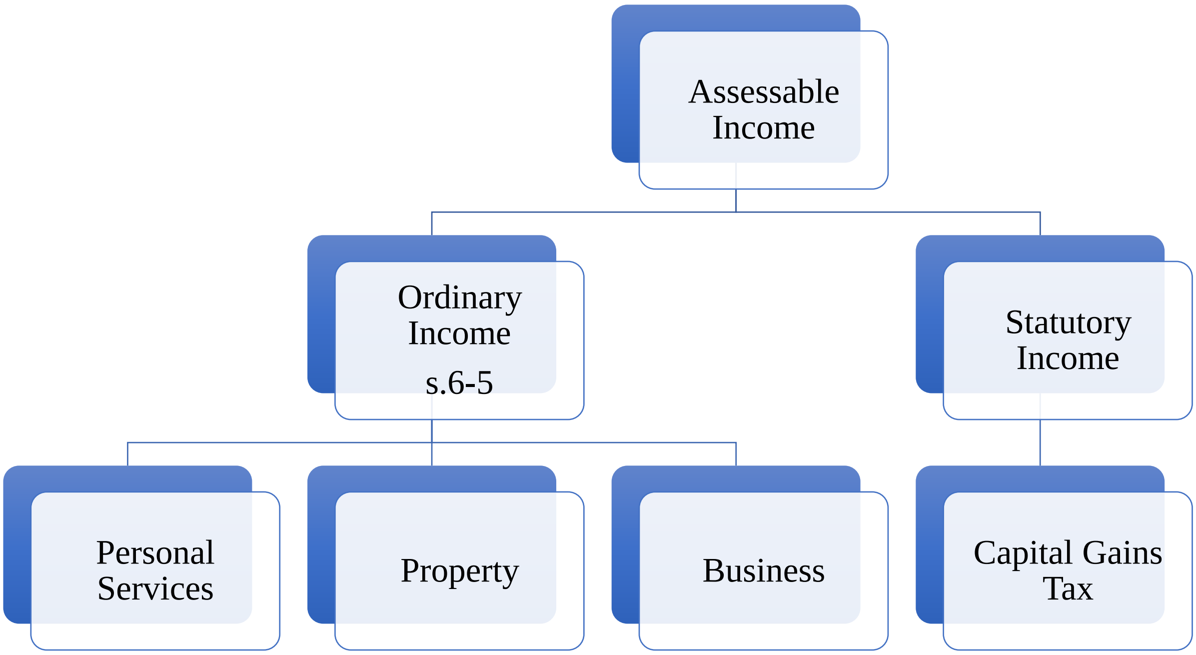
Topic 2: Assessable Income

Taxable Income = Assessable income – Allowable deductions



- Regular/periodic
- Money/Money Work
- Reward for services
- Real Gain
- Flows

ORDINARY INCOME

Prerequisites

1. Cash/Cash Convertible
   a. Cooke v Sherden
2. Real Gain
   a. Hochstrasser

*****Receipts that are not cash or convertible to cash are not ordinary income (remember this is a prerequisite)*****

- The ordinary meaning of income contains a notion of gain that is money or convertible to money. The implication is that if some goods or services are received that cannot be converted to cash then there is no benefit to the taxpayer and therefore no ordinary income.

Hochstrasser v Mayes → *Reimbursement for work-related loss when moving not assessable, not a real gain*	
Facts:	- TP employer required him to move cities - TP sold his house in city he was leaving and received less than he had paid for it. The employer reimbursed him for the less.
Held:	- House of Lords held NOT assessable. - It was not a real gain because he had just been compensated for work related expense. - What if it was not work related? Receipt then would have been a real gain

APPLICATION

Compensation Payments

- Whether compensation constitutes assessable income will depend on the nature of the compensation: *C of T (NSW) v Meeks* (1915) 19 CLR 568.
  - Compensation takes on the same character as what it replaces.
- Compensation for the permanent loss of a capital asset or for a consequent closure of a business will be capital in nature: *Federal Coke Co. Pty Ltd v FCT* (1977) 7 ATR 515.
- Where the compensation is for unliquidated damages and the capital and revenue components cannot be identified, the Australian courts will not attempt to apportion the amount into revenue and capital components: *McLaurin v FCT* (1961) 104 CLR 381.
  - In essence, the courts will treat the whole compensation as a non-assessable capital payment as long as it contains some portion of capital.

Constructive receipts – The amount must be characterised as ordinary income in the hands of the person who derived it. 6-5(4)

- The character of the receipt is determined by reference to the person/entity who derived it. It is not determined by the character of the expenditure that produced the item: *Federal Coke Co Pty Ltd v FC of T* 77 ATC 4255.
- In *Federal Coke* the issue of a constructive recept was also raised. For example, if the taxpayer directs her employer to pay part of her salary to her husband, this amount is still ordinary income of the employee as a constructive receipt.

Reduced Cost Base → No element 3 Expense

Capital Loss = Reduced Cost Base – Capital Proceeds

Section 110 -55

- Capital losses are determined by comparing the capital proceeds with the *reduced cost base*.
- In essence, the definition of reduced cost base is similar to the definition of cost base, but with the following important differences:
    - Reduced Cost Base is not Indexed – Section 110-55(1)
    - Element 3 of the reduced cost base does not include costs of ownership and is very limited.

EXAM TIP

In exam identify whether dealing with a gain or a loss. If you misidentify gain instead of loss just cross out element 3 analysis.

EXAMPLE
House asset (108-5)

CGT Event A1 (104-10)

Acq:20/6/00 Disp:25/11/17/6/00

CG = CP (116-20) 230k – CB (110-25)

Element 1 (110-25(2)) acq cost = $180k

Element 2 Incidental (110-25(3))

legal cost of acq $3,000 (110-35(?))

Selling expenses 10k

Element 3

Interest costs – 5k

Element 4 Capital work; - additions 25k (already had 5k deducted from 30k)

CG $7000 = CP230,000 – CB223,000

‘Dwelling’ – House, Caravan, Boat House, ‘home’ – Section 118-15.

‘Ownership Period’ – Date of acquisition to date of disposal – Section 118-125.

Section 118-110 – Gain exempt if:

- Owned by an individual
- Dwelling is main residence
  - Section 118-115 – Caravans etc,
  - Section 118-120 – 2 Hectares max of adjacent land
  - Section 118-135 – Move into in a reasonable time
    - Selling one MR to move into a new one there is a 6-month period between
    - If building a new MR there is a 4-year period.

Absence

Absence → Section 118-145 ➔ effect is to revert it back to a basic case and access full exemption.

You may be absent from your main residence, and earn assessable income from it, for up to six years provided that you do not have another main residence. You can have two times six year periods.

NOTE – Can only have two periods away.

EXAMPLE

Buy a house in Melbourne → live in it for 4 years → got job in Sydney and lived there for 2 years renting an apartment → rent out the Melbourne one → come back to the Melbourne and sell the other one → exemption applies in full.

Section 118-150/115 – Build/Renovate etc

- Vacant land included for 4 years previous to completion and moving in.

Section 118-160 – Accidentally destroyed

- Exemption continues provided no new main residence.