

Section 6-5 RESIDENCE OR SOURCE OF ORDINARY INCOME

The imposition of taxation per s 6-5 is justified upon the basis of a person's connection to the tax jurisdiction (residence) or alternatively upon the basis of a connection between a person's income and the tax jurisdiction (source).

Preliminary Matters

[Provided Australia does not have an applicable tax treaty with country X which might limit the application of s 6-5, only the ITAA will take effect and person X will not be open to double taxation.]

RESIDENCE (ORDINARY INCOME)

- Subsection 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.
 - [Australian residents include worldwide ordinary income in assessable income]

Residence of Individuals

[Per s 6(1) ITAA 36, there are four limbs of individual residence. The first two discussed below.]

First limb – 'resides'

s 6(1)(a) 36' states that a "resident" is: "a person who resides in Australia.

Ordinary meaning of 'resides'

Determination of whether a person is a resident of Australia is loosely defined and is a question of degree and fact, according to ordinary concepts - the term is not accorded any special meaning (*Miller* per Rich J and Dixon J). To reside ordinarily means to dwell or live at a place permanently or for a considerable period of time (Oxford dictionary) or the place where the individual sleeps and lives (*Nicholson*).

- *Miller*: sleeping and living on boat in international waters. Key factor saying he was not a resident of Aus.

Residence factors

The definition of residence imports consideration of a range of factors. In considering the basket of residence indicia factors (*Miller*), [person X] is likely to be a resident of Australia because:

However, balanced against this is the fact that:

- time spent at the location
- behaviour while in jurisdiction [ie visitor or 'settled' behaviour such as membership of clubs etc]
 - social and living arrangements
- location of immediate family (cf *Miller* where immaterial that wife was in Aus)
- maintenance and location of assets (i.e. acquisition of property)
- place of employment
- subjective intention
- immigration status
- Voluntariness (choice to reside). Despite being contracted to work on the waters, he still voluntarily ordered his life so as to reside in those places.
 - Cf Rich J: emphasised compulsion element to say that he should be Aus, not Milne Bay resident.

This seems to indicate that person X is a resident of Australia because the facts depict that...

[Multiple places of residence are possible (eg *Applegate*, per Northrop J), however.....

[A taxpayer can be a resident even if they subjectively do not believe they are: *Stone*....

The Second Limb – Domicile

s 6(1)(a)(i) 36' states that a resident includes a person whose domicile is in Australia, unless the Commissioner is satisfied that the person's permanent

SOURCE (ORDINARY INCOME)

- subsection 6-5(3): If you are a foreign resident ordinary income derived directly or indirectly from all Australia sources during the income year is assessable
 - foreign residents only include Australian-sourced ordinary income in assessable income

General Rule

If an individual is not an 'Australian resident', only **ordinary income** that has an **Australian source** can be included in his or her assessable income under section 6-5. Determination of the source of income is a question of fact, according to **ordinary usage of 'source'** (*Nathan; Mitchum*). Given the difficulty in unequivocally attributing the source to any one place, various indicators will be considered to say whether, on balance, that place is the proper source of the income (*Spotless*).

[If an amount has more than one source, need to **apportion it across the various sources** — **if unclear, then suggest this**]

Source rules for particular categories of income

[Look at the particular nature / factual circumstance of the transaction to determine how the source should be calculated.]

[N.B. Derivation discussion re cash/accruals may affect when it is treated as income, which in turn affects source discussion.]

Business services

The Courts will look to where the business has been conducted, and source the income according to the place in which **substantive business activity** took place (*Cliffs*). The Courts may also look at where the transaction took effect or where the contract was entered into when determining the source (*Spotless*). [**Whichever one it is depends on what is substantive**]

- *Cliffs (Negotiations)* — **Work carried out**: All **information** used to undertake negotiations came from overseas, all negotiations took place overseas, **contractual relationship maintained**. All the **contracts were facilitated** and carried out by work undertaken overseas.
 - the **commission, re those contracts**, were earned where the **negotiations were performed**, even though the taxpayer carried on business in Australia.
- Cf *Spotless*: **Substantive matters completed**: **Deposit was paid** with interest in Cook Islands, the receipt of **certificate of deposit, conclusion of contract** and **binding of parties** and **delivery of the cheque** all occurred in Cook Islands. This is where the loan agreement came into existence (and took effect)
 - Where they carried on business was considered (Cook Islands).

On the other hand, it is immaterial where contracts or other arrangements which constitute mere formalities take place.

- **contracts securing funds and letter of security given in Aus** (at this stage, was not in satisfactory form to take effect – not bound yet, **merely preparations**) (*Spotless*)
- irrelevant that contracts were executed in Australia, mere formality (*Cliffs*)

Personal Services – employee vs. independent contractor

The manner in which income from personal services are sourced depends on the nature of the service relationship, that is, whether the individual is considered an employee or an independent contractor. Considering, [person X] is an [employee / independent contractor], the source of the income will be determined according to where they [performed their services (minute by minute) / became

..... performed (in NZ).

- Employees paid on minute by minute basis (completion of services) and that is the source.

Mitchum: **Independent Contractor**:

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DERIVED in s 6-5

ITAA97 s 6-5 states that taxpayer's assessable income includes amounts 'derived' in that income year. Dixon J in *Carden* provides that the proper view of derivation involves an approach that produces substantially correct reflex of the taxpayer's true income. This entails consideration of the question: 'what gains have come home in a realised or immediately realisable form? Considering the circumstances of the case and the nature of the source of income, the Court will have regard to accounting concepts — cash receipts or accruals basis — when calculating derivation of the [amount.] (*Arthur Murray*).

[Face value of debt is recognised, not the present value of the debt (ie do not take account of contingencies and/or time value of money when quantifying amount derived) — historical cost, not true value (*Carden*)].

Carden's case: Doctor Carden was a sole medical practitioner over many years. He ended up passing away and there was a question about whether the fees he earned should be recognised for income tax

[Notwithstanding the taxpayer's wish to change method of accounting, the determination as to which particular method truly reflects income in the circumstances rests with the courts (*Henderson*)].

Cash basis accounting

Income is derived under the cash method when it is actually or constructively received (in cash or some other property). In weighing the nature of [person X's profession] — the mode in which it is practiced and [person X's] sophisticated circumstances — the [amount] may be calculated on a cash basis on consideration of three grounds (Dixon J in *Carden*):

1 Non-trader / Stock of vendibles

Pursuant to *Cardens*, non-traders should generally be treated on a cash receipts basis of accounting, given the sophistication of their transactions and flow of income. Dixon J noted that for non-traders,

2 Uncertainty of Income

Analogous to *Carden*, whereby the medical practitioner held a substantial proportion of doubtful or bad debts and have substantial amounts which had been earned but not received, [person X] appears to have [various debts / no debts] as ____.

As the outstandings on the expenditure side [do not / are unlikely to] correspond to and are not naturally connected with outstandings on the earnings side in the context of [business X.....

3 Receipts attributable to skill

The receipts in this case are more attributable to [person X's]

Goodwill as a CGT Asset

Definition of goodwill

Per s 108-5(2)(b), goodwill or an interest in goodwill is a CGT asset. **Goodwill is the legal right or privilege to conduct a business in substantially the same manner and by substantially the same means that have attracted custom to the business (*Murray*).**

Is it goodwill? Sources of goodwill [Only if unclear.]

Goodwill is a **separate item of property distinct from the sources** of goodwill and **does not inhere in the assets of the business (*Murray*)** — sources of goodwill not relevant. Therefore disposal of a source of goodwill may not affect the goodwill of a business, although goodwill is necessarily connected to the conduct of the business that gave rise to it.

Not goodwill asset

[In this case, the [thing/source] may not even be a source of goodwill as it does not attract customers, but merely permits the [lawful exercise of X], analogous to the taxi licence in *Murray* which merely permitted lawful exercise of taxi business.]

[Whether the goodwill attaches to the [activity/methods/asset] depends on the manner in which it is exploited. The licence in *Murray* did not attach goodwill as the taxpayer exploited the licence in a manner other than the business of taxi-driving - they exploited its economic potential by leasing it (rent). [Likewise / Contrastingly, person X] is ____.]

- i.e. **commenced taxi business** (developing goodwill).

Time goodwill acquired....

- **Business method; skill**
- **Location; Personnel;**
- **Externalities** ie imperfect competition; **Know how;**
- **Business assets** formerly owned (para 52).
- name, reputation, situation, industrial relations, management practices, money spent on advertising

NEXUS REQUIREMENT

The loss or outgoing is deductible if: incurred in the course of generating assessable income; or necessarily incurred in carrying on a business for the purpose of generating assessable income (s 8-1(1)). It is sufficient and necessary that the occasion of the outgoing should be found in whatever is productive of the assessable income (*Antis citing Ronpibon*).

- 1st limb: outgoing must be incidental and relevant to gaining or producing assessable income (*Ronpibon*).
- 2nd limb: loss or outgoing must be part of the cost of trading operations to produce income (*John Fairfax*)
- 2nd limb If no plan for the outgoing: 'Necessary' is understood to mean 'clearly appropriate' for conduct of business, without necessarily being planned or desired, such as protection of reputation following public statements made about the taxpayer (*Magna Alloys*).

Causative Factors

Four factors are considered when assessing whether either of the two limbs of the nexus requirement are satisfied. These two limbs may overlap (*Total Holdings citing Fairfax*) as the first limb may include amounts incurred in carrying on a business (*Steele*).

1 Objective Effect of the expense

First Limb

Training (when expense not in the course of doing the job)

First, the [expense] was incurred by [person X] in the course of their employment. Whether there is an objective effect of the expense in producing income depends on the two approaches in *Finn*.

Narrow approach – Enhancing prospects of promotion

Dixon J's approach in *Finn*, endorsed by the Courts, establishes the imperative for the taxpayer to show that the expense enhances their prospects of promotion.

- **Promotion**: Despite being in the position of highest seniority and top of salary scale, his expenses did indeed put him in a better position to get promoted, according to public promotion procedures having regard to the possibility that one of his senior officers were looking to retire in the near future and was putting himself in a competitive position to be promoted above others in the same position.

Liberal approach – Enhancing performance or understanding

On the other hand, Kitto

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4 Temporal Aspect

There must be sufficient proximity' between the expense and derivation of income (*Steele*).

If there the link is with future or past AI: Notwithstanding that the outgoing is linked with a [past/future] production of assessable income, it is possible for taxpayer to incur loss now expecting that income sometime will be generated sometime in the [past/future]: *Jones* (past) and *Steele* (future).

First Limb

Future Income

Even though the prospect of assessable income is remote, the expenses will satisfy the temporal aspect of the nexus test provided the only purpose in undertaking the activity is to generate assessable income (*Steele*). However, the greater the temporal gap, the less likely they will be connected.

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