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MID SEM NOTES

Topic 1: Tax Accounting

- **S 6-5:** AI includes OI you derive directly or indirectly from all sources
- **S 8-1:** Can deduct AI any loss or outgoing to the extent that: **(a)** it is incurred in gaining AI or **(b)** it is necessarily incurred in carrying on a business for purpose of gaining AI
- **Timing issue:** when is income *derived*, and expense *incurred*

General Tax Accounting Methods

1. Receipts and outgoing accounting – look to gross outflows
 - a. Cash accounting
 - b. Accruals accounting
2. Net profit accounting

Issue 1: Choice of System – Receipts / Outgoing approaches

- It there is no statutory rule, TP chooses the method which is calculated to give a substantially correct reflect of the TP true income from that income earning activity:
Carden's case
 - Consider facts / circumstances to determine which is most appropriate
 - May have different methods for different items / activities
- **Cases**
 - *Carden's case* ~ **cash** – **(i)** small scale of activities - sole medical practitioner, **(ii)** income received is in substance a reward for personal work and professional skill involved – medical doctor
 - *Henderson* ~ **accrual** – **(i)** large accounting firm – 295 employees, **(ii)** no one individual was doing personal work and income of individual is no longer in substance a reward for personal exertion
 - *Firstenburg* ~ **cash** – **(i)** small scale – sole practising solicitor, with one employee being a secretary / typist, **(ii)** employee(s) contributed in a lesser and subsidiary degree to professional work performed by TP
- **TR 98/1** – binding on Commissioner, but not on individual
 - (i) Nature of business
 - Salary / wages – usually cash accounting
 - Small business, income earned through application of personal skills and services = cash
 - Capital assets used to produce income, individual skills not important = accruals
 - Employees responsible for directly generating income = accruals
 - (ii) Size of business – larger accruals (*Henderson*) vs small (*Carden's*)
 - (iii) Circulating capital – accruals
 - (iv) Credit policy – readily gives / formal procedures for extending credit – accruals
 - (v) Capital items – plant and machinery to produce income – accruals

Issue 2: Application of System

Cash Accounting

- **(i)** Income – cash accounting means receipt; if no cash is received, no income is derived for the purposes of **s 6-5**

- *When it is received* – consider constructive receipt (**s 6-5(4)**), where TP is taken to have received the amount as soon as it is applied or dealt with in any way on your behalf or as you direct
 - **Permanent Trustee** ~ CR not applicable, lend money to former partner, dissolved
 - **Brent** ~ only \$10k AI – income not dealt with if debtor refrains from repaying debts
- Benefits in kind (no cash received) – **s 21**: money value of property received converted into cash equivalent

Accruals Accounting

(i) Income – should be recognised in the period in which it is ‘earned’ as opposed to when it is ‘received’ [*may be no derivation of income even if amount received*]

- **When is amount earned:**

- **(a)** Only when fees mature into a **recoverable debt** – a point at which you can bill the customer and where payment can be demanded: **Henderson**
 - Consider agreement between the parties and terms of contract
 - Potentially bill in instalments
 - Where not obliged to take further steps before becoming entitled to payment
- **(b)** Often when **invoice rendered** but consider factual circumstances of the case
 - **Australian Gas Light**
 - **Facts:** AGL supplies gas to households
 - Commissioner argued should disclose income because some gas had been consumed / property passed to customers
 - AGL argued no income as not yet taken necessary reading of gas meter nor sent bills to customers
 - **Held:** Not derived – not identified which customer had consumed what amount by end of FY. Reading actual meters was condition precedent to charging customers. Due to nature of billing, they needed to read meter
 - **Ballarat Brewing** ~ discounts can be claimed upfront if **evidence** never refused
 - **Facts:** TP provided prompt payment discount (\$10). Argued only \$90 income
 - **Held:** Yes – evidence showed always allowed discount – certain that the amount that will eventually received by TP is the discounted price, and hence income is the discounted amount