Notes

MLL406 - Taxation Law

Topic 1 – Introduction to Taxation Law

Overview of Tax…

What is tax?

- Tax is a "a compulsory execution of money by a public authority for public purposes, enforceable by law, and is not a payment for services rendered."
- Is a pecuniary burden placed upon individuals or property to support the government
    - A financial charge or other levy imposed by legislative authority.
- Tax operates on a federal level
- Everyone must pay it
    - Enforceable by law: means people have a **legal responsibility to pay**
    - Matthews v Chicory Marketing Board (1938) 60 CLR 263

Who implements tax?

- **The Australian Tax Office:** The ATO is the body responsible for the oversight of taxes
    - When taxes are not fully paid, civil penalties (such as fines), must be imposed on the non-paying entity or individual

Who administers tax?

- Power of administration of the tax laws is vested in the **commissioner of the taxation office** → currently Chris Jordon

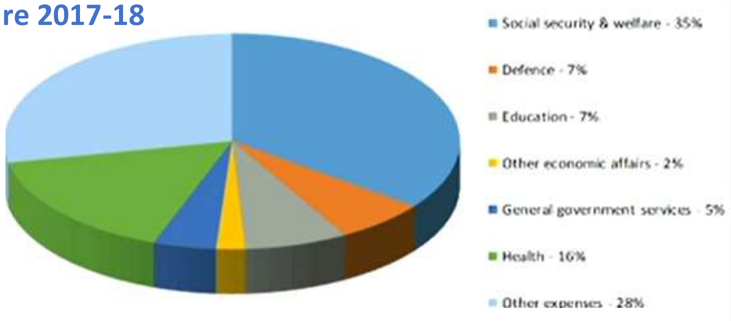
Purpose and effect of tax…

Taxes are used by the State & Fed Governments to <u>improve the welfare of the people</u>.

- **Effect:** Taxes act as a form of income for the government, thus the govt has discretion where the money is spent. It becomes an economic task, and the government must consider all stakeholders.
- **Specific purposes:**
    - State/Federal governments implements the use of taxation money for things such as:
        1. Roads, schools, hospitals, social welfare, infrastructure (Public purposes)

Projected Commonwealth Government expenditure 2017-18

- Majority of tax spend on **social security** → ensuring everyone has a basic standard of living
- A lot also spent on **health**: Medicare and the system Australians rely on



<u>Sources of Tax Law</u>

1. Legislation
2. Case Law
3. Practice of tax law ruling issued by the Commissioner of Taxation

Rulings:
- The statutory officer administering the tax law, being the Commissioner of Taxation, issues "Rulings"
- Ruling are NOT law, but the opinion (considered) of the Commission.
- Can be challenged in the Courts.

Topic 2 (Part 1) – Assessable Income
"Ordinary Income"

STEPS TO IDENTIFY INCOME TAX PAYABLE

STEPS TO IDENTIFY "INCOME TAX PAYABLE" …

Step 1: Identify what income is **"assessable income"** ***

- Refer to all content within this topic
  - There is no definition of 'assessable income' in s(1) ITAA 1997
  - **S 6-1 ITAA 1997:**
    1) Assessable income is made up of = **statutory income** and **ordinary income**
    2) Some ordinary income, and some statutory income, is **exempt income**

  Exempt income

  - 2 types:
    1. Exempt because of the type of income it is (6-20 and 6-23)
    2. Exempt because of the type of entity that earns the income
       - Eg, income earned by a non-for profit income

Step 2: Identify **"taxable income"**

- **Taxable income = Assessable Income – Allowable deductions**
  - set out in s 4 – 15 ITAA 1997

Step 3: Identify **income tax payable**

- **Formula: Income Tax Payable = (Taxable income x Tax Rate) – Tax offsets**
  - set out in s 4-10 ITAA 1997
-
  - NOTE: *Need to determine **assessable income** to be able to calculate **taxable income***

Method statement

Step 1. Add up all your assessable income for the income year.

To find out about your assessable income, see Division 6.

Step 2. Add up your deductions for the income year.

To find out what you can deduct, see Division 8.

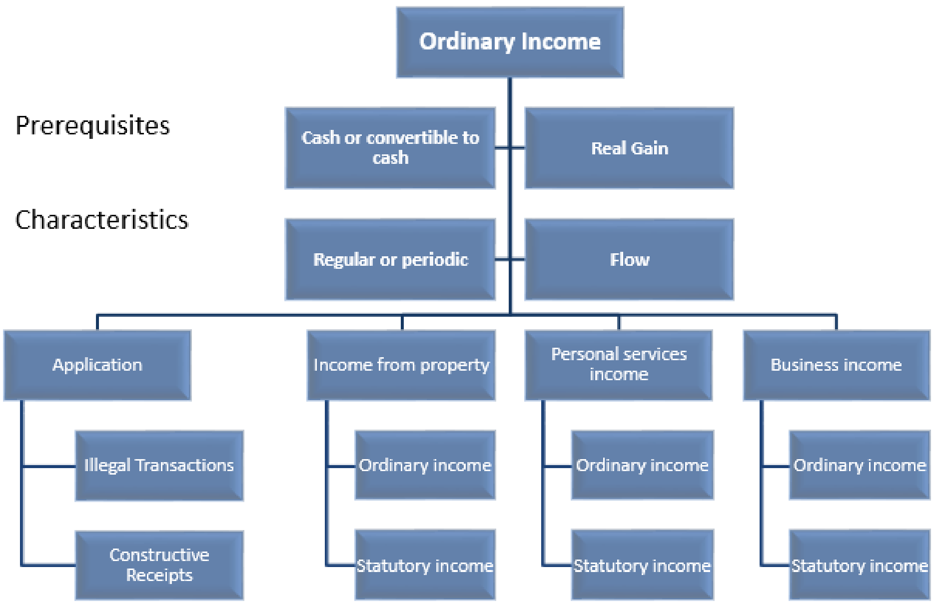
Step 3. Subtract your deductions from your assessable income (unless they exceed it). The result is your taxable income. (If the deductions equal or exceed the assessable income, you don't have a taxable income.)

Note: If the deductions exceed the assessable income, you may have a tax loss which you may be able to utilise in that or a later income year: see Division 36.

OVERVIEW OF LECTURE – ORDINARY INCOME

1. Provisions of the ITAA 1997 relating to ordinary income – s 6-5 ITAA 1997
2. Prerequisites of Ordinary Income
    - **Prerequisite 1:** Receipts that are **not cash or convertible to cash** = NOT OI
    - **Prerequisite 2:** Receipts which are **not real gain** = NOT OI
3. Characteristics of Ordinary Income
    - Regular or periodic
    - Flow
    - Particular income year
    - Income must be held by the person who derived it
    - Nexus with services
4. Issues regarding applications
    - Mutuality, illegality
5. Types of ordinary Income
    - Income from Personal Services including Ps v Capital
    - Income from PROPERTY
    - Income from BUSINESS including Bus v Cap

ORDINARY INCOME OVERVIEW



What is Ordinary Income – Summary

What IS Ordinary Income?

- Real gain
- Money or monies worth (Cash or cash convertible)
- Generally regular
- Connection with an earning source: EG…
    - Reward from services (personal)
    - Return from capital and labour (business)
    - Return from investment (property)

What is NOT income?

- Capital receipts
- Personal Gifts - Prizes
- Chance winnings
- Income from creational activities
- Non-cash receipts

1. Relevant Provisions regarding 'Ordinary Income'

Interpretation of Ordinary Income Provision

Operative Provisions

Part 6, section 6-5

S 6-5 (1): **Definition of Ordinary Income**

- defines ordinary income as 'income according to ordinary concepts'

S 6-5 (2): **Income taxable for Australian Residents**

- 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.

What subsection 2 means:

- If you are **Australian resident**:
  - You are taxable on all sources (world-wide income)

S 6-5 (3): **Income taxable for Non-Australian Residents**

- If you are a **foreign resident**, your assessable income includes
  (a) the ordinary income you derived directly or indirectly from all Australian sources during the income year; and
  (b) other ordinary income that a provision includes in your assessable income for the income year on some basis other than having an Australian source.

What subsection 3 means:

- If you are NOT an Aus resident:
  - You are only taxable on your income from Aus sources

S 6-5 (4): **Notion of constructive receipt**

- in working our whether you have derived an amount of ordinary income, and (if so) when you derived it, you are taken to have received the amount as soon as it is applied or dealt with in any way on your behalf as you direct (**Federal coke, doesn't matter where you direct your income** as long as you've derived it)
  - **Federal coke:** doesn't matter where you direct your income as long as you've derived it, it is considered income
    - Cannot just transfer money to someone else to avoid paying income tax on the amount

2. Prerequisites of Ordinary Income

2 Prerequisites of ordinary income

Prerequisite 1: Receipts that are not cash or convertible to cash are NOT OI
Prerequisite 2: Receipts which are not real gain are NOT OI

Prerequisite 1: Receipts that are not cash or convertible to cash are NOT ordinary income

- The ordinary meaning of income contains a notion of gain that is money or convertible to money
- s 15-2 and s 21A ITAA: provisions catch some non-cash convertible amounts as assessable income
    - Parliament broadened the concept of income
- IN EXAM:
    1. Is it cash?
    2. Is it convertible cash?

    = If no to both, unlikely to be considered ordinary income

    3. Consider s 15-2 and s 21A
        - Parliament introduced provisions to catch some non-cash convertible amounts into assessable income
- Relevant case:

<table>
<tr><td align="center">Cooke v Sherden (1980)
Receipt of non-cash-convertible holiday (not OI) – holiday not OI
Why? Because it was not cash and could not be converted to cash</td></tr>
<tr><td>FACTS:
- Tax payers sold drinks door to door (drove around to houses)
- They received a free holiday from the soft drink manufacturer as a result of them selling a certain number of drinks.
- The holidays were non-transferable & it could NOT be sold
HELD:
- The holiday was NOT considered ORDINARY INCOME
- Why? Because it was not cash and could not be converted to cash
**The court followed the principle in the case of Tenant v Smith (1892)</td></tr>
</table>

<table>
<tr><td align="center">Payne v FCT (1996)
Frequent flyer points and free flights as a result of employment were not OI
Why? They could not be sold in any way or converted to money so they were not cash or cash convertible</td></tr>
<tr><td>FACTS:
- Payne travelled regularly due to employment with a large accounting firm
- Flights were paid for by her ER, as trips related to their business
- Payne signed upto Frequent flyer points and obtained lots of FF points which amounted to free flights
ISSUE:
- Were the Free Flights which were obtained due to frequent flyer points (obtained as a result of employment) considered OI?</td></tr>
<tr><td>HELD:
- The free flights earned were NOT OI.
- <u>Why?</u> Because the tickets were not money or money worth and they could only be used by the program member or his/her nominee
- They could not be sold in any way or converted to money so they were not cash or cash convertible</td></tr>
</table>

Isolated Transactions cases:

- business-like methodology

Whitfords Beach (1982) **(ORDINARY INCOME - OI)** Change of **intention** and **extent of development** – changed the transaction to constitute the sale of property
FACTS: ▪ Whitefords Beach Pty Ltd purchases land in 1954 to gain access for the shareholder to their beach shacks (the purpose of the purchase was purely domestic, not commercial) ▪ The property became valuable and shareholders wanted to sell it ISSUE: ▪ Was the profit realised on the sale of land a mere realisation of a capital asset, or was the company now in the business of selling land making the profit of the sale income in ordinary concepts. HELD: ▪ The profit on the sale was income in ordinary concepts (OI, 6-5 ITTA) Importance was placed on the change in ownership and intention of the company, which was outlined in the company's constitution

Stevenson **(OI)** Case agrees with Whitford IN EXAM: where the TP does majority of the work re the sale of property themselves, thus has a **high degree of personal involvement,** more likely sale will be considered OI, not capital – as shown in this case. (unlike where a TP uses an agent and does not do majority of the work, more likely be considered Capital)
FACTS: ▪ TP decided to scale back his farming activities and sell most of his property ▪ He could not find a purchaser and then commenced a subdivision himself ▪ He obtained some finance and engaged in extensive activates ▪ TP **personally dealt with the council and engineers and advertised the sale himself (no agent)** ▪ TP subdivided his block into 220 blacks and sold 180 ISSUE: HELD: ▪ The TP's personal involvement, made the activity look more like the activity which characterises carrying on a business ▪ TP carried on the business of subdividing, developing and selling land = assessed as OI ▪ This judgement agreed with Whifords case given the magnitude and scale of the development which was a relevant indicator, so the **degree of personal involvement** in carrying out the subdivision was primarily made it constitute OI

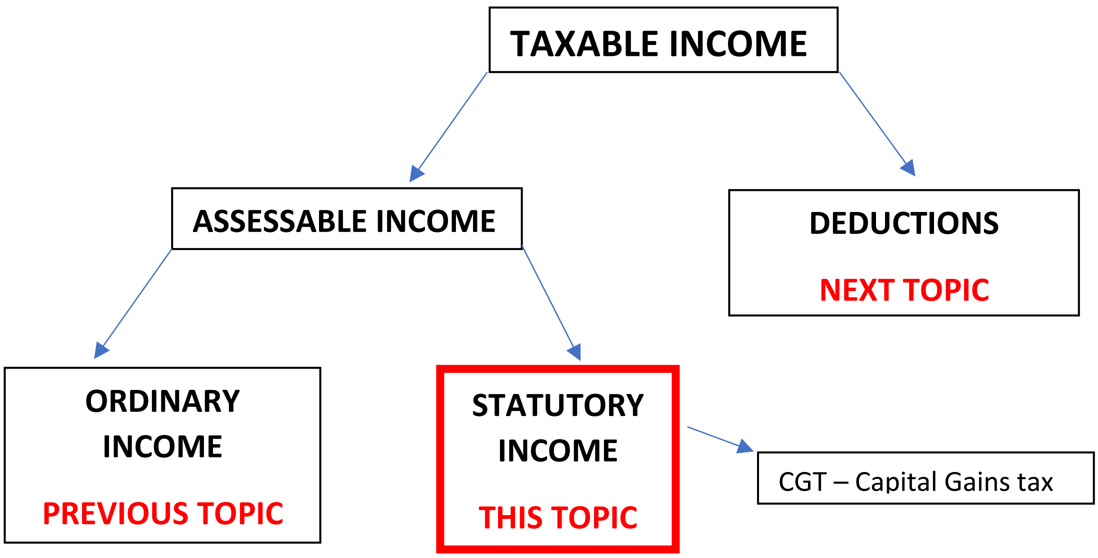
Statham (1988) Case helps with identifying the purpose of acquisition **(Capital taxed in accordance with CGT provisions)**

Topic 2 (Part 2) – Assessable Income

“Statutory Income”

OVERVIEW

*outlines where SI fits into the course so far….



STATUTORY INCOME - INTRODUCTION

What is SI?

- Statutory income is an amount that is specifically made assessable by the Act: s 6-10 ITAA 1997
- SI provisions range from very specific; eg, s 15-5 (accrued leave transfer payments) through to very general and complex; eg Part 3-1 (capital gains tax).
- SI = INCLUDES CAPITAL GAINS TAX (CGT)

Dividends

- s 44 ITAA 1936: dividends received constitute assessable income as statutory income.

Income assessable under more than 1 provision:

- 6-25 ITAA 1997: if an amount if SI and it concurrently could be OI (or assessable under more than one provision), 6-25(2) ITAA 1997 states the SI takes precedence, UNLESS there is a **contrary intention** present.
    - Contrary intention means – must first check OI

SI – Sections of ITAA must know

- s 6-10 ITAA 1997: Merely states that Statutory Income exists
- s 44 ITAA 1936: **dividends** received constitute assessable income as statutory income
- 6-25 ITAA 1997: if an amount if SI and it concurrently could be OI (or assessable under more than one provision), 6-25(2) ITAA 1997 states the SI takes precedence, UNLESS there is a **contrary intention** present.

- S 15 -2 ITAA 1997: allowances and other things provided regarding employment or services **VERY IMPORTANT SECTION

  3 REQUIREMENTS:
  1. Need a nexus with employment services
  2. Needs to be an allowance, gratuity
     - But if just being reimbursed = still not assessable (not as OI or SI)
  3. Provided to Tax Payer

  - S 15 -2 (1) personal services
    - Needs to be a nexus with some type of services and reward
    - "Your assessable income includes the value to you of all allowances, gratuities, compensation, benefits, bonuses and premiums, provided to you in respect of your employment of services."
  - S 15 -2 (2) deals with cash convertibility
    - Makes personal services income (whether cash, cash convertible or NON-cash convertible) ASSESSABLE.
      - Eg: if you have a phone as a part of your salary, it is not OI as it is not cash or cash convertible, however can be caught here
  - S 15 -2 (3) values which are **NOT included as assessable income**, under this section:
    - a) superannuation lump sum *or* an employment termination payment
    - b) an unused annual leave payment or an unused long service leave payment
    - c) a dividend or non-shared dividend
    - d) an amount that is assessable as **OI** under s 6-5, cannot be **SI**;
      - this is saying → You cannot bring an amount in under SI 15-2 ITAA 1997, before first considering OI under s 6-5
      - EG: Is the gift a proper gift, or is it payment for services… if it is grey and not clear nexus with services nor clear gift consider 15 -2, because 15-2 has a lower threshold.
- S 15 -3: Return to work payments
- S 15 -5: Accrued leave transfer payments
- Div 82: Termination of employment (i.e. redundancy payment)
  - NOT COVERED IN THIS UNIT
- S 15 -20: royalties
  - A royalty can be classified as SI, but must check OI first
  - In exam – talk about OI royalties first, then state, "however if the royalties don't fall under OI, then can fall under SI s 15-20 ITAA 1997.

Topic 3 (Part1) – "CAPITAL GAINS TAX"

Assessable Income – Statutory income - CGT

Capital Gains Tax (CGT) Introduction

- A capital gain IS assessable
  a) Comes under statutory income
- To be subject to CGT there must be:
  1. An **asset**
  2. An **CGT event**
  ^ Both prerequisites of CGT
  3. Identifiable **timing** (when asset bought/sold)
  4. Calculate the **gross gains** and/or **loss** (gross amount as yet to consider deductions)
  5. Identify any concessions or discounts to the gain/loss
  6. Identify the final **gross loss or gain figure**
- Difference to OI:
  a) unlike OI, there is less cases, more legislation and will be easier as there is a right answer.

CGT Answer Plan

Step 1. Identify an **asset** (108-5 ITAA 1997)

- 2 classes of assets:
  1. Collectables
  2. Person Use Assets

Step 2. Identify a **CGT event** (108-5 ITAA 1997)

- Is there a loss or gain from the asset? **Don't need to know all events, only need to know A1, C1** (loss or destruction) **& C2, D1** (creating a contractual right in another person)**, F1, H2.**

Step 3. Identify the **timing of the event**

- When did the TP **buy** the asset?
- When did the TP **sell** the asset?

Step 4. 'Calculate' the **gross gains** and/or **loss**

(gross amount as yet to consider deductions or concessions – i.e. raw gain or loss)

- Capital Gain (CG) = Capital Proceeds (CP) – Cost Base (CB)
- Capital Loss (CL) = Reduced Cost Base (RCB) - Capital Proceeds (CP)

+ modifications to these formulas ^^

Step 5. Identify' any **discounts/concessions** to the Gain or Loss

- Div 115 ITAA 1997 (what are the capital proceeds) / modifications?
- 50 % general discount
- Exemptions and concessions

Event A1 S 104-10(1) **Change in ownership of CGT asset**	Event C1 S 104-20 **Loss or destruction of CGT asset**	Event C2 S 104-25 **Cancellation or ending or an Intangible asset**	Event F1 S 104-110 **Lease, lease renewal/extension**	Event D1 S 104-35 **Creating a contractual right in another**	Event H2 S 104-155 **Money paid, but no contract**
- Doesn't include contractual rights Capital gain = Capital Proceeds - Cost Base Capital loss = Capital Proceeds – Reduced Cost Base	Event occurs **without the CGT asset being transferred** to a new owner: FCT v Orica (1998	**a.** Being redeemed or cancelled *(shares/debentures)* **b.** being released/discharged, or satisfied (*a debt*) **c.** expiring (*contractual rights)* **d.** being abandoned or surrendered (contractual rights)	The time of the event: the grant of a lease is when the contract for the lease is entered into; or if there is no contract--at the start of the lease. For a renewal or extension--at the start of the renewal or extension.	The time of the event: is when you enter into the contract or create the other right s104- 35(2).	H2 event happens when there is **MONEY PAID** amount, paid in relation to an asset, but there is **no contract** (thus not like a D2)

3. Importance of 'timing' on CGT…

Step 3. Identify the **timing of the event**

- When did the TaxPayer **buy** the asset?
    - **A1 event:** s 109-10 ITAA 1997: For an asset you create you acquire, timing occurs on the date you buy it / when change of ownership occurs (i.e. contract date)
- When did the TP **sell** the asset?
    - **A1 event:** s 142-10 ITAA 1997: you dispose of an asset if the change of ownership occurs from you to another entity
        - **Note: use the contract date, NOT the settlement date**

4. Calculating CGT

Step 4. 'Calculate' the **gross gains** and/or **loss**

(gross amount as yet to consider deductions or concessions – i.e. raw gain or loss)

- **Capital Gain (CG) = Capital Proceeds (CP) – Cost Base (CB)**
- Capital Loss (CL) = Reduced Cost Base (RCB) - Capital Proceeds (CP)

+ modifications to these formulas ^^

Relevant Sections

Capital Proceeds – what amount did they sell it for?

Div 116 ➔ amount you get when you disposal/sell an asset ***market value**

- Capital proceeds = what you get for an asset when you sell it
- S 116-20 (1) ITAA 1997: General Rule about CP
    a) CP is the money you have **received**, or are **entitled to receive**, when you sell an asset

Topic 4 – Deductions

Part 2 - Specific Deductions

Where a loss or outgoing is a deduction under multiple provisions, choose the most appropriate (Specific over general): s 8-10 ITAA 1997

Range of specific deductions

Division 25 ITAA 1997: outlines specific deductions

1. Tax related expenses: s 25-5 ITAA 1997

2. Repairs: s 25-10 ITAA 1997

3. Borrowing Expenses: s 25-25 ITAA 1997

4. Lease document expenses: s 25-20 ITAA 1997

5. Bad debts: s 25-35 ITAA 1997

6. Travel between workplaces: s 25-100 ITAA 1997

Other deductions

1. Donations
2. Tax Losses
3. Black Hole Expenses
4. Depreciation

Div 25 deductions in detail…

1. Tax related expenses

- s 25-5 ITAA 1997: any amount incurred in managing tax is deductable.
- Managing tax affairs includes expenses for:
    - Preparing/lodging tax returns, BAS, etc.
        - Must go to a registered accountant ect to be able to obtain deduction
    - Travel associated with obtaining tax advice
    - Appeals to Australia Appeals Tribunal or court regarding tax affairs
    - Obtaining valuations needed for a deductible gift or donation: ATO website
- Cannot deduct:
    - s 25-5(2) ITAA 1997: outlines what you cannot make deductions for:
        - Tax paid or withheld
        - Expenses/interest on borrowings to pay tax

Fringe Benefits Tax – 'FBT'

Relevant Act: Fringe Benefits Assessment Act 1986 (Cth)

Introduction

- Introduced from 1 July 1986
- Before FBT introduced, there was only Ordinary Income or Statutory Income
    - Result was = a lot of amounts were not being taxed
    - But now, FBT catches the amounts which we were escaping being taxed

What is fringe benefits tax?

- Is a benefit, other than a salary or wage
- Generally something **private associated** with it

<u>Examples:</u>

- A home loan below the normal benefit
    - Eg: An employee works for CommonWealthBank and gets a home loan for a lower interest rate that normal, the difference between the normal interest rate and what rate got will be a fringe benefits
- Employer pays for home phone or electricity = fringe benefit
- Employer send EE on holiday with family = fringe benefit

Who pays fringe benefits tax?

- The employer pays FBT
- S 23L ITAA 1936: provision which removes FBT from being assessable by the employee, and instead it is assessable for the employer

3 steps taken to determine FBT (IN EXAM)

Step 1. Determine whether a benefit has been provided to an Employee or associate in respect of employment

Step 2. If YES to 1, determine the type of fringe benefit (categories of Fringe Benefit)

Step 3. Calculate the taxable value of the benefit/s and the FBT liability (TAX CONSEQUENCE)

(no calculations required)

Step 1. Determine whether a **benefit** has been **provided to an EE** or **associate** in respect of employment

(BENEFIT PROVIDED?)

<u>Definition of a fridge benefit</u>

- The benefit must meet the below requirements outlined in 136(1) Fringe Benefit Assessment Act 1986 (Cth) ('FBAA 1986') to meet the definition of a fringe benefit…

Taxation Avoidance

'Anti-avoidance provisions- Part 4A ITAA 1936'

Relevant Anti-Avoidance Provisions

- **Part 4A ITAA 1936** governs tax avoidance schemes entered into after 27 May 1981
- Relevant sections within Part 4A include:
  - Ss 177A – 177G ITAA 1936

Tax avoidance concerns (this unit addresses)

1. Is the tax payer **reducing assessable income**?

OR

2. Is the taxpayer maximising/**increasing their deductions**?

When will the Anti-Avoidance Provisions (Part 4A) apply…

- <u>The anti-avoidance provisions will only apply when the 4 requirements are met:</u>
  1. **Scheme:** Scheme is defined in ss 177A ITAA 1936
  2. **Benefit:** Scheme must be entered into to gain a tax benefit (i.e. to deduce assessable income or maximise deductions): ss 177C and 177B ITAA 1936
  3. **Dominant purpose:** The dominant purpose was to obtain the benefit: s 177D

- IF the anti-avoidance provisions apply:
  1. **Cancel any benefit:** s 177F ITAA 1836
  2. **The Commission can amend the return:** s 177G ITAA 1836

<u>4 requirements in detail…</u>

1. **Scheme**
   - Scheme is defined in s 177A ITAA 1936
     - A scheme is an agreement, arrangement, understanding, promise or underlying, whether express or implied, whether enforceable or not, or intended to be enforceable, or a plan, proposal or action (s 177A ITAA 1936)

   - FCT v Hart (2004): TP has a main residence property
   - Spotless: Scheme identified, to reduce the assessable income of TP
   - Peabody v FCT (1994): Scheme NOT identified

   IN EXAM: State what the scheme is arrangement is (i.e. to have a separate loan facility) thus, as scheme applies as per s 177A ITAA 1936 and the Commissioner would likely have a similar finding as in Spotless (where scheme identified)