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Topic 1: Intro to Tax (Formulas)

General Structure of Income Tax

1. s. 4-1 ITA 97 + s. 9-1 ITA 97 → Individuals and companies **must** pay income tax

1.1 s. 4-10(1) ITA 97 → tax period is 12 month period from July 1 to June 30 (s.995-1)

Amount of Tax Payable?

1.2 Rule to Calculate Tax Payable: s. 4-10(3) ITA 97

(a) Tax Payable/Liability = (Taxable Income x Rate) – Tax Offset

(i) **Step 1:** Work out your taxable income (see below)

(ii) **Step 2:** Work out tax rate using Income Tax Rates Act (below)

(iii) **Step 3:** Work out tax offsets (Franking credits)

(iv) **Step 4:** Deduct the tax offset from the amount you owe to ATO

(v) **Result:** Tax liability/Tax credit (ATO owes you money)

1.3 Rule to Calculate Taxable Income: s.4-15 ITA 97

(a) Taxable Income = Assessable Income – Deductions

(i) **Step 1:** Add up all your Assessable Income (**AI**); s.6 ITA 97

(ii) **Step 2:** Add up all your deductions for the year; s.8 ITA 97

(iii) **Step 3:** Subtract deductions from Assessable income

(iv) **Result:** Taxable Income

1.4 Rule to Calculate Assessable Income:

(a) Assessable Income = Ordinary Income + Statutory Income

(b) **Ordinary Income**; s.6-5 ITA 97

(i) Income according to ordinary concepts and usages of mankind: *Scott v COT* (1935)

(ii) **Includes:**

A. Income from Property

B. Income from Services

C. Income from Business

D. Compensation Receipts

E. Periodic Receipts

(c) **Statutory Income**; s.6-10 ITA 97 (see s.10-5 for list of things defined as **SI**)

(i) **Includes:**

A. Capital Gains (Taxed separately) s.10-5 ITA 97

B. Dividends; s.44 ITA 36

C. Imputation credits; s.10-5 ITA 97

1.5 What's NOT Assessable Income? s.6-15 ITA 97

(a) **Exempt Income:** s.6-20 ITA 97

(i) Income will be **EXEMPT** if the legislation says it is.

(ii) Exempt income can be used to soak up tax losses. For example, you have a $100 tax loss, but $50 of exempt income, that $50 will be offset against $50 of your tax loss, so you ONLY get the benefit of half your tax loss (you only have a $50 tax loss).

(b) **NANE:** s.6-23 ITA 97

(i) Income will be **NANE** if the legislation says it is.

(ii) NANE income is not assessable AND not exempt, so it has NO relationship to your deductions (doesn't soak up tax losses)

(iii) Example: Income received by a TP/Employee receiving a fringe benefit is NANE; s.23L(1) ITA 36 (because employer has already paid the tax for you)

Australia's Progressive Income Tax Rate Scale (Residents Tax Rates 2017-18)

1.6 s.37 Income Tax Rates Act 1986

Taxable Income	Tax on this Income
$0 – $18,200	Nil
$18,201– $37,000	19c for each $1 over $18,200
$37,001 - $87,000	$3,572 plus 32.5c for each $1 over $37,000
$87,001 - $180,000	$19,822 plus 37c for each $1 over $87,000
$180,001 and over	$54,232 plus 45c for every $1 over $180,000
NB:	2% Medicare levy not included. Add it to your calculations 2% extra levy for people who earn over $180,000 (WTF)

1.7 The above rates are the **MARGINAL income tax rates**

(a) Meaning they tell you how much tax you have to pay for EVERY EXTRA DOLLAR YOU EARN.

(b) This means that the NEXT DOLLAR you make at $18,201 (which pushes you into the 2nd tax bracket → the 19% tax rate is only applied to THAT dollar.

(c) **Example 1:** If you made $18,201 in 2018, your tax liability would be:

(i) $0 + 1 x 0.19 (19%) = 0.19c is your tax liability.

(d) **Example 2:** If you made $81,000 in 2018, your tax liability would be:

(i) $81k (taxable income) – $37k (end of previous bracket) = $44,000

(ii) That $44k would be taxed at 32.5%.

(iii) $3572 + (32.5% for each $ over 37k) = tax liability

(iv) $3572 + ($44k times 0.325)= tax liability

(v) $3572 + $14,300 = tax liability

(vi) $17,872 = tax liability

1.8 What about the EFFECTIVE tax rate?

1.9 An effective tax rate simply reflects what a TP paid % wise in a year.

1.10 Formula: Tax paid ÷Taxable Income = EFFECTIVE Tax rate

(a) **Example 2 (see above):**

(b) $17,872 (Tax liability/paid) ÷ 81k (taxable income) = 22%

(c) The person in the example above paid 22% of his salary in taxes in 2018, and incurred a tax liability of $17,872.

Topic 2: Capital Gains Tax

Distinguishing Capital Gains from Income from Property:

1.11 Income from property is 1 of the categories of ordinary income according to ordinary concepts and usages of mankind.

1.12 This is different from Capital Gains:

(a) **Income from Property:** income from the **use** of property

(i) Interest → income from the use of money

(ii) Rent → income from the use of tangible assets

(iii) Royalties → income from the use of intangible property (IP)

(b) Gains from the realization of property's value (**CGT**) (non-recurrent income)

(i) When you make a gain from the way you change the format of HOW you hold your property/wealth.

Capital Gains Tax (CGT) Generally; Division 100 ITA 97

1.13 Only applies to assets purchased after 1985

1.14 CGT only applies upon the occurrence of a **CGT event**; s.100-20 ITA 97

(a) These CGT events are all found in s.104-5 ITA 97

(i) **A1:** Disposal of a CGT Asset

(ii) **C2:** End of a CGT Asset

(iii) **D1:** Creating contractual or other rights

1.15 Is part of your **statutory income**; s.10-5 ITA 97

(a) This means it is assessable income, BUT it's just a NET amount you plug into the assessable income calculation; s.102-5(1) ITA 97

(b) It is a calculation that is done separately from any other form of income.

Individual CGT Calculation Formula; s.100-45(1) ITA 97

1.16 Individual gains and losses made on **each CGT event** are calculated by:

1.17 Formula:

(a) Capital Gain/Loss = Capital Proceeds (sold) – Cost Base (bought)

1.18 Steps:

(a) **Step 1:** If Capital Proceeds > Cost Base = Capital Gain

(b) **Step 2:** If Capital Proceeds < Cost Base = Go to Step 3

(c) **Step 3:** Determine the reduced Cost Base (rCB)for the asset

(d) **Step 4:** If rCB > Capital Proceeds = The difference is your Capital Loss

(e) **Step 5:** If the CP are LESS than the CB but MORE than the rCB, you have NEITHER a capital gain or loss

Calculating your Cost Base; s.110-25 ITA 97

1.19 You want this to be as HIGH as possible, so that you have less Capital gain

1.20 The cost base of a CGT Asset consists of 5 elements

(a) **Element 1:** Money and Property (market value) given in respect of acquiring the CGT asset (2)

(b) **Element 2:** Incidental costs (3)

(i) List at s.110-35

A. Remuneration of Agent/Lawyer/Professional

B. Cost of Transfer

C. Stamp Duty

D. Cost of Advertisement

(c) **Element 3:** Cost of owning the CGT Asset (4)

(i) Interest on money borrowed to acquire the asset

(ii) Interest on money borrowed to increase the asset's value

(iii) Cost of maintaining, insuring or repairing asset

(iv) Land tax (if the asset is land)

(d) **Element 4:** Capital expenditure to increase/preserve value of the CGT asset or Capital expenditure to install/move the asset (5)

(e) **Element 5:** Capital expenditure to establish/preserve/defend title to the CGT asset (6)

Calculating your REDUCED Cost Base: s.110-55 ITA 97

(f) If prima facie you have a capital loss based on formula (above), instead use the same steps as normal cost base, but remove element 3 and calculate it again

Market Value Substitution Rule (Cost Base/rCB); s.112-20 ITA 97

1.21 The FIRST element of your CB or rCB will be replaced with the Market Value of the CGT Asset (at the time of its acquisition), if either 1 of these 3 applies:

(a) 1. No expenditure (you didn't pay anything for it) (doesn't include D1)

(b) 2. Can't value the expenditure

(c) 3. Not an arm's length dealing

1.22 The effect of this provision is that the ATO will treat you as if you paid market value for that CGT asset.

Calculating your Capital Proceeds; s.116-20 ITA 97

1.23 General Rule:

(a) Capital proceeds from a CGT event = money received (or entitled to be received) + Market value of any property received (or entitled)

(i) The market value of any property received above is calculated as at the TIME of the CGT event (when you sold it in the case of an **A1** event)

1.24 Payment in Instalments: s.103-10 ITA 97

(a) If you are to receive $ at a later time or by instalment, you are treated as having received the amount when you are entitled to it

(b) Bad Debt Situation and you never actually receive it? s.116-45 ITA 97

(i) Capital Proceeds will be reduced by the unpaid amount if:

A. Not likely to receive it

B. Not because of anything you omitted to do

C. Took all reasonable steps to get unpaid amount paid

Market Value Substitution Rule (Capital Proceeds); s.116-30 ITA 97

1.25 NO CAPITAL PROCEEDS: s.116-30(1) ITA 97

(a) If NO capital proceeds received from the CGT event, you are taken to have received the **market value** of the CGT asset (worked out as at the time of the CGT event)

1.26 SOME CAPITAL PROCEEDS: s.116-30(2) ITA 97

(a) The capital proceeds from a CGT event are replaced with the Market Value of the CGT asset IF:

(i) Some or all proceeds cannot be valued, or

(ii) Those capital proceeds are MORE or LESS than the Market value of the asset, AND

A. Parties didn't deal at arms length

B. The CGT asset was a C2 event

FINAL CGT Calculation Formula; s.102-5(1) ITA 97

1.27 Your Net Capital Gain (if any) goes into your assessable income as a **net amount**

1.28 You CANNOT apply your net capital losses (if any) into your assessable income; s.102-10(2) ITA 97

(a) **Step 1: Reduce CG's for the year by Capital losses for the year:**

(i) 1. Calculate each gain/loss for each event

(ii) 2. **Strategically** Reduce the individual gains by the individual losses

A. Since the TP can choose the order in which they can reduce their capital gain, REDUCE the capital gains that are NOT subject to the 50% discount first.

(b) **Step 2: Apply the Balance of Prior Years' Unapplied Net Capital Losses**

(c) **Step 3: Apply the Discount (if available);** s.115-5 ITA 97

(i) A discount will ONLY apply if all 4 elements are satisfied s.115-10 – s.115-25 (inclusive)

(ii) **Element 1:** To be a discount capital gain must be made by an individual, trust, complying SUPER; s.115-10 ITA 97

(iii) **Element 2:** Discount capital gain must have been made AFTER 21 September 1999; s.115-15 ITA 97

(iv) **Element 3:** Discount capital gain must NOT have indexed CB

(v) **Element 4:** Discount capital gain must be on asset acquired at least 12 months before; s.115-25 ITA 97

(vi) **Result if ALL elements satisfied:**

A. Discount percentage is **50%** if gain made by individual or a trust; s.115-100(a) ITA 97

B. Discount percentage is **33%** if gain made by SUPER or Insurance fund; s.115-100(b) ITA 97

C. This means that the rate structure stays the same, but only **HALF of the gain is taxed** (remember ONLY the gains are taxed)

(d) **Step 4: Not Examinable**

(e) **Step 5: Add up remaining capital gains together to get NET Capital gain for the year**

(i) You're likely to have a few different assets that have produced a capital gain, so just mash those up together, and THAT is the NET number that goes into your assessable income; s.102-5(1) ITA 97

KEY CGT Concepts:

2. **What is a CGT Asset?**; s.108-5(1) ITA 97

2.1 A CGT asset is any kind of property which is legal, or an equitable right that is not property per se.

(a) Examples:

(i) Land

(ii) Shares or Options

(iii) Debts owed to you

(iv) A right to enforce a contractual obligation

3. **Acquisition of a CGT Asset;** Division 109 ITA 97

3.1 General Rule: You acquire a CGT asset when you become its owner

4. **Time of CGT Event;**

4.1 Timing of the event given separately for each event in s.104-5 ITA 97 but the default rule is often when the contract for disposal is entered into; for **A1** event s.104-10 ITA 97

CGT Implications of Life Events:

5. **Gift:**

5.1 In the CGT context, a gift is deemed as a sale at MARKET VALUE

(a) Donor treated as if selling at MV (Capital Proceeds); s.116-30 ITA 97

(b) Recipient treated as buying at MV (Cost Base); s.112-20 ITA 97

5.2 **Death:** Division 128 ITA 97

5.3 It's just a rollover. Whoever receives the asset from you steps into your shoes. So their CB will be the day the deceased had bought the CGT Asset, then they pay the capital gains tax (if any), on the CGT event when they dispose of the asset.

CGT Concessions:

6. **Main Residence:** s.118-B ITA 97

(a) Capital gain or loss on CGT event that happens to your MAIN RESIDENCE is exempt form CGT to the extent that the property not also being used to produce assessable income.

6.2 Requirements: s.118-10 ITA 97

(a) 1. Individual

(b) 2. Dwelling was individual's main residence throughout period of ownership

(c) 3. Ownership not acquired as beneficiary/trustee of deceased's estate (you bought it)

(d) 4. Event is a ‘relevant’ one

PQ Tips:

6.3 If your client is underselling their asset so that it can all be sold to one buyer, take the stock option

6.4 If your client is overselling their stock to an eager beaver, then take the cash

6.5 Because the CB is the MV of the thing you gave up (in the **subsequent transaction**).