Taxation Law Mid-Semester Exam Notes – Ordinary Income

INTRODUCTION: APPROACH TO SUBSECTION 6-5(1)

State: As an [individual/body corporate], [X] is captured by s 960-100 ITAA97 and falls within the definition of ‘entities’ and therefore s 4-5. His/her ordinary income is thus assessable income. ‘Ordinary income’ is defined in subsection 6-5(1) ITAA97 as ‘income according to ordinary concepts’.

However, there is limited statutory guidance on this phrase – definitions of ‘income from personal exertion’ and ‘income from property’ in s 6(1) ITAA36 are of limited use, given that ‘income’ appears on both sides of the definition (*Brown*).

Subsection 6-5(1) is treated as a direct reference to Jordan CJ’s statement in *Scott* (cited in *Stone*) – namely that the definitional phrase states the essential nature of the inquiry – whether an amount is ‘income’ – and is not a mere matter of ‘ritual incantation’ (*Montgomery*, *Anstis*).

However there has not been any close analysis of Sir Frederick Jordan’s statement, but judges have adopted **indicia of income** rather than necessary and sufficient criteria for classifying amounts as ‘income’:

1. It is **money, or capable of conversion to money** (*Tennant*);
2. **Beneficially received** (*Zobory*);
3. Not **mutual receip**t (*Bohemians*);
4. **Periodic receipts** are generally income (*Myer*);
5. **Not of a capital nature**, but a business dealing with an apparently capital asset *may* give rise to an income receipt (*Whitfords*, *Westfield*);
6. Must be **income in the hands of the recipient**, typically taken to require an ‘earning activity’ of a prescribed kind (**services, business or severance of gain from property**) (*McNeil*), although *Anstis* recognised that an amount can be ordinary income even if none of these typical cases applies.

<table>
<tr><td rowspan="4">Cash/cash-convertible

NB: arguably this element must always be satisfied</td>
<td>✓ For [X], all of the amounts are cash/cash-convertible since:
▪ the amounts are money; <u>or</u>
▪ [benefit] is clearly received in substitution for cash – [X] forfeited right to receive cash in return for receipt of the benefit (eg a holiday); <u>or</u>
▪ there is nothing to suggest he/she generated a ‘receipt from him/herself’.</td></tr>
<tr><td>Substitution principle – is the benefit taken instead of income?
Tennant:
❖ If [X] received the amount in substitution for income it may be ordinary income.
❖ <u>Held</u>: Taxpayer was not receiving the right to live on the premises in substitution to a salary (nothing in the contract saying that).
❖ Furthermore, the tenant cannot sub-let the property.
Payne:
❖ <u>Held</u>: Frequent flyer points were not received in lieu of income.</td></tr>
<tr><td>✗ Benefit is locked to a person (not saleable on market)
Payne:
❖ The reward tickets available because of the frequent flyer points accrual could be used <u>only by the member of the program or his/her permitted nominee</u>.
❖ The tickets were non-transferable and, if sold, were subject to cancellation.
❖ They were not money and could not be turned into pecuniary account.</td></tr>
<tr><td>Benefit requires further input to be sold (eg idea → copyright)
❖ [Amount] is not income since it is not ‘from its own nature’ convertible to cash (Tennant). This amount requires additional input/effort from the recipient to be saleable for cash.</td></tr>
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	Benefit is a non-transferable option ❖ Conversion to cash may be direct or indirect (***Payne***). Thus, exercise of a non-transferable option, despite not being prima facie saleable for cash, may be exercised with the 'underlying property' and sold (***Payne*, citing *Abbot***).
Beneficially received	✓ There is no suggestion that his/her receipt of the amounts attach an obligation to hold the amount for a third party.
	√ Recipient intends to give the amount to a 3rd party ❖ Although [X] intends to pay over the amount to [3rd party], this intended use does not defeat the fact it was beneficially received when the payment was made. Nothing suggests [X]'s intentions have created a trust obligation (*Zobory*).
	✘ Recipient holds the amount on trust (eg wrongdoing or ET)/cannot apply $ for own benefit ***Zobory***: ❖ Facts: Z defrauded money, mixed with own and made profit. ❖ Held: A CT arose and thus money not received by Z personally (on trust for victim). No beneficial receipt.
Not mutual receipt	✓ There is nothing to suggest he/she generated a 'receipt from him/herself'. ✘ Members' subscriptions and payments for services (bar or dining facilities, etc) are not income of a non-profit club or association formed to pursue a common object. ▪ Rather, members' contributions are, in substance, advances of capital for a common purpose which are *expected to be exhausted during the year* for which they are paid. ▪ If anything is left **unexpended**, it is **not income or profits but savings** which the **members may claim to have returned** to them.
Periodic receipts	✓ [Payments XYZ] are regular/recurrent/periodic. ✘ While [Payments ABC] appear to be one-off transactions, this is not determinative of the income question (*Myer*).
Not of a capital nature	**State:** We must now turn to an examination of the final two indicia (capital, income in the hands of the recipient).
Income in the hands of the recipient	

INCOME IN THE HANDS OF THE RECIPIENT – AMOUNT [A/B/C]

NB: You are now approaching the payments one by one.

State: Whether [A/B/C amount(s)] are income in [X]'s hands hinges on whether they are (choose relevant ones):

1. **Business income**
   - *Trigger: the receipt was part of the business of the taxpayer/was outside the scope but pursued with profit-making motive*
2. **Income from services**
   - *Trigger: provision of services with connection to payment*
3. **Income from property**
   - *Trigger: property involved/ severance amount from property (all-out sale)*
4. **Are captured by the approach in *Anstis***
   - *Trigger: continuum of receipts which are relied upon by the taxpayer (eg. Centrelink payments)*

INCOME FROM BUSINESS

State: The amount cannot appropriately be described as income from property, or income from services, or income of the kind contemplated in *Anstis* because:

- ❖ Property: no property involved/no severance of amount from property (all-out sale)
- ❖ Services: no services already performed/ to be performed (nothing expected in return)
- ❖ *Anstis*: one-off transaction. There is no chain of repetitious receipts which are relied upon.

The receipt is most likely to be business income.