

## **Comprehensive Taxation Law Notes SM2 2019**

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**How to answer hypotheticals – Techniques****IRAC**

- **Issue** – Identify and state the legal issues arising from the fact situation
- **Rule** – Identify and state the legal principles or ‘rules’ relevant to those issues
- **Application** / analysis – apply those legal principles or rules to the facts, for one side and then the other, but doing so on an issue-by-issue basis
- **Conclusion** – draw a mini-conclusion after evaluating how the legal principles apply to the particular issue that has been raised by the facts

**TOPIC 1 INTRODUCTION**

**Why tax?** Achieving policy objectives, Collection and redistribution mechanism

**Power to tax?** Commonwealth/Federal Government has the revenue-raising abilities while the states have major spending responsibilities.

**Sources of Tax Law** – IT, GST, FBT etc (Tax legislation); Case Law/General Law/Common Law

**Tax Administration in Australia – ATO**

- **Assessment of Tax** (self-assessment system; “Carrot & stick” approach i.e. rulings TR; IT; TD)  
T/P lodges IT return → ATO issues ‘Notice of Assessment’ → T/P or ATO Amending Assessments → T/P Objections and appeals
- **Collection of Tax**  
PAYG withholding (employee salary); PAYG instalments (business/invst income); TFN withholding

**TOPIC 2 TAX PAYABLE AND INTRODUCTION TO INCOME****Basic Formula and fundamental terms**

- *s3-5 ITAA97* IT is payable each year
- *ss3-5; 4-1 ITAA97* by each individual, company and some other entities (trustees sometimes; superannuation funds *s 9-1 ITAA97*)
- *ss4-10(1)(2) & 995-1 ITAA97* Financial Year (income/tax year) = 1 July to 30 June (unless SAP T/P)

***s4-10 ITAA97* Income Tax Payable = (Taxable Income \* Tax Rate) – Tax Offsets**

**Taxable Income (*s4-15 ITAA97*) = Assessable Income less Deductions**

- Assessable Income (*s6-1*) = Ordinary Income (*s6-5*) AND Statutory Income (*s6-10*) BUT NOT Non-assessable income (*s6-15*)
- Deductions = General Deductions (*s8-1*) AND Specific Deductions (*s8-5*)

**Australian Resident Tax Rates (2019 – 2020)**

Taxable income	Tax on this income
\$0 - \$18,200	Nil
\$18,201 - \$37,000	19 cents for each \$1 over \$18,200
\$37,001 - \$90,000	\$3,572 plus 32.5 cents for each \$1 over \$37,000
\$90,001 - \$180,000	\$20,797 plus 37 cents for each \$1 over \$90,000
Over \$180,000	\$54,097 plus 45 cents for each \$1 over \$180,000

not including 2% 'Medicare Levy'

**Tax Offsets**

- Income tax credit/rebate
- Listed in *s13-2 ITAA97*
- Ordering rule in *s63-10 ITAA97*
- 2 categories
  - Recognition of other taxes paid on same income
    - Foreign IT offset (Topic 8)
    - Franking credits (Topic 10)
  - Subsidy offsets
    - 'welfare' offsets: e.g. Low IT Offset; Low and Middle IT Offset; dependent rebates
    - 'Incentive' offsets → e.g. R&D; overseas defence force services; zone rebate

**Low Income Tax Offset (LITO)**

TAXABLE INCOME	LITO OFFSET
\$0 - \$37,000	\$445
\$37,001 - \$66,666	$\$445 - [(\text{Taxable income} - \$37,000) \times 1.5\%]$
$\geq \$66,667$	Nil

NB: non-refundable offset *ss159N ITAA36 and 67-20 ITAA 97***Low and Middle Income Tax Offset**

INCOME(\$)	OFFSET
< 37,000	\$255
37,001 – 48,000	$\$255 + [7.5\% \times (\text{Income} - \$37,000)]$
48,001 – 90,000	\$1,080
90,001 – 126,000	$\$1,080 - [3\% \times (\text{Income} - \$90,000)]$

NB: non-refundable; temporary 2018-19 to 2021-22

**Assessable Income** (AI (*s6-1*) = OI (*s6-5*) AND SI (*s6-10*) BUT NOT Non-assessable income (*s6-15*))

**Ordinary Income** = "income according to ordinary concepts". Any gain that is regarded by the court as being of an income character will be "ordinary income" and assessable under *s6-5 ITAA97*. In discussing what gains are of an income character (OI), the judge in Scott (1935) said that it must be "determined in accordance with the ordinary concepts and usages of mankind".

Prepared Answer: Assuming that XXX is an Australian resident, then XXX's AI (*s6-1*) includes all OI(*s6-5*) and SI (*s6-10*) BUT NOT non-assessable income (*s6-15*) derived directly or indirectly from all sources during the FY.

Three Broad Categories of Income: 1. Personal services and employment; 2. Business; 3. Property

**Features of OI:**1. Sufficient nexus with an income-earning activity

- Income from services, business or property; but also, the exceptions below:
- *Keily v FCT* (1983) Gov. aged pension was OI because of the traits it had: regular, expected and depended upon by the T/P for support.
- *Anstis v FCT* (2010) Youth Allowance payments constituted OI. This principle is not restricted to gov. benefits and could apply to other regular payments.

2. NOT a capital gain

*Eisner v Macomeber* (1920) (US) → the “flow concept” (fruit & tree analogy)

- Income is like the fruit of the tree; it gives you continuous discrete gains and just because you don't get fruit one year doesn't mean you won't get it the next year. Picking the fruit doesn't affect the underlying asset (the tree).
- Capital gains are like the tree, it gives you a one-off gain when you cut it down and no more income will flow from it.

**Prerequisites of OI:** the three prerequisites are necessary but not sufficient for a gain to be OI.

1. Must be money or convertible to money

- *Tennant v Smith* (1892) Tennant the T/P provided with free accommodation from employer, not allow to sublet the accommodation. Thus, the court held not income as not convertible to cash.
- *Cooke & Sherden* (1980) Cooke received a free holiday that cannot be transferred to anyone else, the commissioner tried to assess it on the value of the free holiday, but the court said no, it's not convertible to money.
- NB: s21A on non-cash business benefits: s21A deems business receipts as being cash-convertible. This means that for business T/P a receipt can constitute OI despite not being cash or cash-convertible.

2. Must be a realised gain

- *Eisner v Macomeber* (1920) (US) unrealised gain not OI.
- If shares appreciated in value but not yet sold, not CG (unrealised)
- Rent is income, house appreciate in value is capital gain [subject to CGT]
- Dividend is income, profit from selling the shares is capital gain
- Dividend assessable under s44 ITAA36 [Statutory Income]
- Some receipts are neither income nor CG (gifts/inheritances)

3. Must be a real gain (must be derived by the T/P)

- *Countess of Bective* (1932) T/P received money from a trust that was set up for her daughter benefit. So, she had to use the money from the trust for her daughters' benefit. The commissioner came along and assessed the T/P on the money from the trust saying it was OI. But the high court said that it wasn't OI as she hasn't derived any gain from it. It was for her daughters' benefit. Today's use: reimbursement of a client.
- *Hochstrasser v Mayes* (1960) reimbursement for work-related loss upon moving premises is not assessable.

- NB: OI constructive receipt rule s6-5(4) prepared answer: Although XXX arranged for his employer to pay 5% of his salary to his parents each month, he is deemed to have derived the income under the constructive receipt rule (s6-5(4)). As it has been dealt with as per his instructions, it will be assessable to him regardless of the fact he did not actually receive it.

### Characteristics of Ordinary Income

#### Usually periodic, recurrent and regular

- *Harris* (1980) one-off lump sum made to top up pension and the court said it was not OI but capital
- *Blake* (1984) same facts as Harris except fortnightly payments, thus, periodic, recurrent and regular, OI
- *Keily v FCT* (1983) Gov. aged pension was OI because of the traits it had: regular, expected and depended upon by the T/P for support.
- *FCT v Dixon* (1952) employee offered top-up payments (OI) if they sign up to be soldiers for WWII. Regular, expected and depended upon. Compensation principle: payments compensate lost salary so the compensation takes the form of what it is replacing.

### Things to note

#### Characterised in the hands of the T/P

- *Federal Coke* (1977) Bellambi received compensation income from Le Nickel and gave it to coke, found to be a gift to Coke because Coke didn't derive it from services and was thus not OI in Cokes hands – however since then the constructive receipt rule has been introduced which would mean that they could go after Bellambi.

#### Illegality

- *La Rosa* (2003) the TP was a convicted drug dealer who was robbed of cash during an intended drug purchase. He claimed deduction for the loss incurred in the robbery when commissioner sought to assess T/P income from drug dealing. It was allowed in this case, but this case attracted widespread publicity and gov. further introduced s26-54 which denies a deduction.

#### Principle of 'mutuality'

- *RACV* (1973) you cannot pay yourself income, income is something that has to come from somebody else. The best example of this is membership fees. Membership fees are not income as the members are the association so the fees are not income to the association, you can't pay yourself income. These receipts are a type of non-assessable non-exempt income under s6-23.

#### Compensation payments

- *Dixon* (1952) the general rule with compensation payments is that they take on the character of the loss that is being compensated, if its replacing something that would be capital, then the payment is also capital. If it's replacing something that would be OI then the payment is also OI.

**Statutory Income:** Amounts that are included in assessable income by specific provisions of the income tax legislation *s6-10(2)*

- Royalties *s15-20* states that your AI includes an amount that you receive as or by way of royalty within the ordinary meaning of royalty IF the amount is not assessable as OI under *s6-5*
- Dividends *s44(1)* states that the dividends are AI
- Allowances, etc. for employment/services *s15-2* part of AI as SI; however, can also be OI under *s6-5*
- Net capital gains *s102-5* since 1985, CGs are assessable as SI

Overlaps between OI and SI: Amount is included in AI only once *s6-25(1)*, **usually SI prevails** as stated in *s6-25(2)*, if it is dealt with by the statutory provisions then you must include it as SI unless the provision states otherwise. E.g. *s15-2(3)(d)* discussed above.

Overlaps between *s6-5* (OI) and *s15-2* (Allowances): *s15-2(3)(d)* explicitly states that an allowance, compensation, benefits and bonuses that are assessable as OI under *s6-5* are not included in AI under *s15-2*. **(OI prevails)**

**NB: *s15-2 ITAA97* formerly *s26(e) ITAA36*:** introduced to capture the “gap” where *s6-5* does not satisfy and the FBTAA does not apply, i.e. amounts must be money or convertible to money to be OI.

**NB: SI Constructive receipt rule *s6-10(3)*** income is treated as being derived by a person when that income has been dealt with as that person directs.

## Non-Assessable Income

### Two Types *s6-15*

- Exempt income *s6-20*: income on which you don't pay tax, all expenses associated with deriving the income are not deductions. However, exempt income is taken into account when calculating the tax losses of earlier income years that can be deducted *s36-10* (calculation of a tax loss).

Including certain Australian Government pensions, allowances and payments; certain overseas pay and allowances; some scholarships, bursaries, grant and awards.

- Non-assessable non-exempt (NANE) income *s6-23*: income on which you don't pay tax and does not affect your tax losses including super co-contributions; tax-free component of an employment termination payment; certain genuine redundancy payments and early retirement scheme payments.

### Four Categories

1. Entity is exempt *s11-5*: no matter what kind of income it has i.e. certain charitable institutions, local governments.
2. Particular income is 'exempt' *s11-15*: i.e. social security payments, educational scholarships *s51-10*, foreign employment income *s23AG* (Topic 8).
3. Particular income is NANE *s11-55*: i.e. FB *s23L(1)* (Topic 4); foreign branch income *s23AH* (Topic 8)
4. Miscellaneous: exempt, FB *s23L(1A)* (Topic 4); Non-cash business benefits < \$300: *s23L(2)*

### TOPIC 3 Income from Services

*s15-2(1)*: AI includes the value to the T/P of all allowances, gratuities, compensation, benefits, bonuses and premiums, allowed, given or granted, in relation to the employment or services rendered.

However, **2 problems (in reality, very few cases under *s15-2*)**:

1. Valuation → extremely subjective i.e. valuing the holiday as it is subjective to ‘value to you’; and,
2. ‘Associates’ not included i.e. spouse or friend;

Thus → **FBT regime introduced (Topic 4)**

Overlaps between *s15-2* and FBT regime: FB prevails *Note to s15-2*

Overlaps between *s15-2* and *s6-5* (OI): OI prevails *s15-2(3)(d)*

**3 things *s15-2* might capture:**

1. Capital amounts received in a services context
2. Rewards for volunteer work
3. Payment from 3<sup>rd</sup> party, not cash or convertible, or organised

#### **Personal Services or Employment Income**

1. Is it a FB (Topic 4)? only relevant if ‘income’ provided is from employer to employee, NOT a 3<sup>rd</sup> party
2. Is it OI *s6-5*?
3. Is it caught by *s15-2* (here, the nexus test much easier) or CGT Event D1 (Topic 7)?

If you receive an amount in a services environment which is not caught by these 3 things, then NOT assessable.

#### **Salary and Wages (OI *s6-5*) (NOT FB)**

- Classic form of ordinary income – payments for the provision of services
- *Hayes (1956)*: An amount that is a “product or incident of employment or a reward for services rendered” will be OI.
- Tax is usually collected from the employer on behalf of the employee under the PAYG system

Prepared answer: salary and wages are regarded as OI according to *Hayes (1956)*. Therefore, under *s6-5*, XXX’s salary \$XXX should be included in his AI as OI. Additionally, salary is explicitly excluded from FB under *s136(1)*.

#### **Allowances**

- Predetermined amount made to cover an estimated expense which is paid regardless of whether that expense is incurred (and how much the expense is): *RTA Case (1993)*; TR 92/15
- Cf. reimbursement: compensation made in respect of the T/P’s actual expenditure.

#### Tax treatment:

- Allowance → AI: OI or *s15-2*; However, OI prevails *s15-2(3)(d)*, so likely to fall under *s6-5*. Allowance is OI and any part of the allowance that has been spent is a deduction.
- Reimbursement → NOT OI but FB, subject to FBT; so no AI consequences for employee.

### Voluntary Payments and Gifts from A Third Party (not your employer)

Benefit from a 3<sup>rd</sup> party may be income where it is a “clearly recognised incident of employment”: *Dixon (1952)*; *Holmes (1995)*. For instance, tips are *AI Penn v Spiers & Pond Ltd (1908)*; *Great Western Railway Co. v Helps (1918)*; *Calvert v Wainwright (1947)*.

- Receipts from third parties (and employer, e.g. a bonus) will be OI for the taxpayer if they are truly a reward for services (Hayes, 1956); and,
- Amounts earned directly or indirectly by virtue of a TP’s personal exertion will constitute OI: *Moorhouse v Dooland (1955)*.
- Strong nexus between the benefit received and the services performed by the employee, and **employment/services performed should be the sole and motivating cause of the benefit**: *Laidler v Perry (1965)*. Then it is more likely to be OI under s 6-5 and assessable to the TP.
- Once it is shown that there is a nexus between the benefit and the activity performed, it does not matter whether the payment is made before, during, or after the completion of the task: *Hochstrasser v Mayes*
- It is also irrelevant whether the benefit is provided by the entity for which the task was performed, or by an unrelated third party: *Kelly (1985)*

**NB:** If the payment is made where **personal or other characteristics of the recipient are the sole and motivating cause of the benefit**, then the receipt is a **personal gift** and will not be OI as there is no connection with any “personal exertion”.

### Voluntary Payments and Gifts – Factors: income vs. gift

1. Whether the TP has been otherwise adequately remunerated for their services
2. Whether there was another relationship between the T/P and the provider
3. Whether the benefit is solicited
4. Whether the benefit can be traced to some activity by the recipient for which the provider is grateful
5. Whether the benefit is of a kind which is a common incident of the recipient’s occupation
6. Whether the benefit is available to anyone or a particular class of T/Ps
7. Whether the benefit arose in the course of employment/services
8. Motive of the donor
9. Recurrence of the payment

**[1, 2, 4, 7] Brown (2002):** a property worth over \$1m was given to the T/P as a thank you for the assistance. The court looked at the fact “had the T/P been otherwise adequately remunerated for his services, so that made the property more likely a payment for services provided”? They looked at any other relationship, which could explain the provision of the property. The only relationship was the services relationship which made the property more likely to be income. Also, has the T/P done something for which the provider is grateful? Yes, in this case so that the court established that the property was **income**.

**[4, 7] Holmes (1995):** The T/P was an employee on a shipping vessel which happened to be near a leaking oil tanker. The leaking oil tanker was heading towards the shore; this meant that there was a risk of the oil tanker losing most of its cargo and causing an environmental disaster. T/P and some co-workers were able to use the vessel they were on to tow the oil tanker out of danger. As a result of his effort, the T/P received a payment of \$23,381 “salvage reward”. T/P would not have received the reward had the efforts of towing the oil tanker to safety been unsuccessful. Thus, the reward was **income**.



**[1, 2, 3, 5] Scott (1966):** Scott administered the estate of the deceased client, and the client gave Scott a gift of 10k. The fact that Scott had been remunerated for his service makes the amount a **gift**. 10K is not a common incident → more likely to be a gift. More, the T/P and the provider builds a friendship so that the 10k is less likely to be income. Additionally, the T/P did not ask for the payment, it is completely voluntary payment outside of the employment or services so that it is more likely to be a gift.

**[2, 6] Laidler v Perry (1965):** a Christmas bonus was paid to all current and past employees in the form of a voucher that could be redeemed for goods. These vouchers were provided regardless of the pay rate or the personal circumstances of the employee and were accompanied by a letter expressing the board's thanks for past services. It was an **income** as benefit is an incident of employment. It arose out of employment as it did not arise out of anything else. If payment is made for some other reason i.e. personal qualities, then the receipt is a personal gift.

**[2, 6] Smith (1987):** Westpac introduced a scheme to encourage its employees to undertake study that it considered related to banking. Under this scheme, the employer would give the employees a certain dollar amount upon successful completion of every subject of an approved degree and an extra amount upon successful completion of that approved degree. At the time there were no tertiary fees so, in effect, the employees who received this money could use it for personal purposes. Smith was an employee who undertook approved study and received money under this scheme. The amount received was **income** as Smith has been an employee to be eligible for the scheme provided by the donor of the gift and the scheme existed to increase employee productivity.

**[1, 2, 3, 4, 8] Hayes (1956):** Hayes was the supervising and general accountant for Mr Richardson's business. Mr Richardson's business was taken over by a company of which Hayes was a director, secretary and shareholder. R persuaded H to sell his shares to him but H remained as a director and secretary. The company went successful and R was allotted a considerable number of shares. R transferred 12,000 shares to H. in a rescue mission on the sea and received a gift from a 3<sup>rd</sup> party as a reward. The high court concluded that the shares were **personal gift** but not OI. H and R developed friendship over years. H had been fully paid for his services and therefore the shares were not additional reward for his work.

**[8, 9] Dixon (1952):** Employee offered top-up payments (OI) if they sign up to be soldiers for WWII. Employees were only paid this top up because they were going to war, if they were going to any other job it wouldn't have been paid. Thus, motive of the donor is a factor. In Dixon, the fact that the T/P relied on these receipts to support himself and his family was a factor in the Court concluding that the receipts were a replacement for **income** and therefore assessable as OI.

**Competition Prizes** (if prize indirectly related to income-earning activity → go back to gift vs income factors)  
Not income unless

- T/P carrying on a business (Topic 5) OR
- Prize directly related to T/P's income-earning activity: *Kelly (1985)*; IT 167 OR

***Kelly (1985)*:** The T/P received a 20k prize from a radio station as an award for the "best and fairest football player". Although unexpected, the prize directly related to his skill and performance as a professional footballer. The prize was OI because first, Kelly was eligible because he was a member of the football club and second, he was awarded the prize because of his skills and abilities.

**Things to think about:** degree of professionalism; for services vs personal qualities; paid before or after service; T/P contracted or not.

**Ruling IT 167:** created because reality TV shows now require a lot of personal exertion and there is a long time period involved. It refers to: 'Radio and Television Competition Prizes'.

- Extensive personal exertion and skill

## Common Employment Amounts

### 1. Superannuation

- Not a FB s136(1)(j) FBTAA
- Not AI when initially “received”, i.e. paid into superannuation fund in employee’s name, why? Going back to one of the prerequisites of OI, it must be “derived” by the T/P, T/P makes a real gain.
- Tax consequences for employee arise when amount withdrawn from superannuation fund

### 2. Frequent flyer points (loyalty programs)

- Not a FB as not provided in the context of employment from employer to employee
- Not AI: Payne (1996) (employer paid the tickets; Payne paid the membership); TR 1999/6
  - Not OI because not convertible to money
  - Not assessable under s15-2 because not connected to employment (separate agreement between T/P and airline)
  - NB: If the employer pays for the employees’ membership of the frequent flyer program, then it would be caught under FBT or s15-2. However, if the benefit is convertible to money, then the question of the benefit’s assessability as OI will rest with whether the benefit shows a nexus with income-earning activity.

## Other Examples

**Provision of knowledge** (what you are being paid for is your provision of services but not your knowledge)

Brent (1971) Mrs Brent was the wife of the infamous criminal Ronald Biggs. Brent was arrested in Melbourne where she had been living with Biggs following his escape from a UK gaol. After her arrest, Brent was approached by many newspapers and she signed an agreement with *The Daily Telegraph* to give it exclusive rights to publish her story and require Brent to attend interviews. T/P argues that it is not OI as she gave up her capital rights to her story as she signed over the exclusive rights to the newspaper. Brent’s earnings were **OI** because Brent was essentially paid for her services of telling her story and she did not give up or dispose of any property. Her secret knowledge was not property as it was not acquired through the conduct of a business and did not relate to anything to which copyright could be attached. The knowledge was not owned by her.

## Compensation payments

Phillips (1936); Bennet (1947): the compensation payment is capital because it is replacing the fact that he gave up having total control of a radio station to go into a situation where he did not have total control. Thus, it is compensating him for total control, where control is a capital asset. Look at what it is being replacing, in this case, it is the loss of control which is capital asset. Hence, the payment is **capital gain**.

**Restrictive covenants** (where you paid not to do something)

Higgs v Olivier (1952): Olivier paid to give up his vocation of acting for 18 months. This was giving up a capital asset and therefore, it was a capital amount. Thus, **not OI**.

Woite (1982): Woite played for South Australian team and signed an agreement with North Melbourne Club that he would not play for any other club except for North Melbourne in Victoria. In return, he received a payment of 10k. The commissioner argued that this was income in relation to his employment or services, but the court said that giving up his right to play for any other team was giving up a capital asset. Thus, the payment is capital. Thus, **not OI**. NB: the amount would highly likely to become an OI if Woite subsequently played for North Melbourne.

**Sign-on fees:**

Sign-on fees entices the party to enter the contract are quite common in professional sporting contracts and some higher-level professional employment contracts. Whether they are a capital payment for giving up some valuable right or whether they are OI in the form of payments for future services?

Jarrolld v Boustead (1963) Capital in nature, rugby player was paid a 3k sign-on fee to give up his amateur status and turn professional. At this time in UK, there were some advantages in being an amateur and there was a chance that he could become an international player at amateur level. Thus, the court held it was capital.

TR 1999/17: where a sign-on fee is a normal part of the practices of attracting sportspeople and employees into a new contract, the payment is less likely to be capital and more likely to be OI as a one-off payment for future services.

Pickford (1998): T/P was offered a salary package to take up employment with another firm, and this package included a one-off payment of 20k as compensation for given-up share options in an employee share scheme with his current employer. T/P consequently accepted the offer and worked for the firm. Thus, the 20k was OI because it was an incident of the T/P's income-earning activity and employment.

**Capital Amounts**

- Not OI s6-5 BUT
- Could be 'AI' under s15-2: OR

AAT Case 7752 (1992): AAT stands for Administrative Appeals Tribunal. T/P was compensated by his employer for losing the right to have a day off every fortnight. The employer had unilaterally terminated this right and had compensated him with three months' salary paid over three instalments. NOT OI but capture by s15-2 as the T/P's employment was the cause of the payment. However, AAT case is not binding precedent on future court decisions.

Smith (1987): Westpac introduced a scheme to encourage its employees to undertake study that it considered related to banking. Under this scheme, the employer would give the employees a certain dollar amount upon successful completion of every subject of an approved degree and an extra amount upon successful completion of that approved degree. At the time there were no tertiary fees so, in effect, the employees who received this money could use it for personal purposes. Smith was an employee who undertook approved study and received money under this scheme. The amount received was **income** as Smith has be an employee to be eligible for the scheme provided by the donor of the gift and the scheme existed to increase employee productivity. Under s15-2, the nexus test is much easier.

- Could be 'AI' as a 'capital gain' (Topic 7): s102-5 ITAA97
  - CGT Event D1 → same outcome as s15-2

### Topic 4: Fringe Benefits Tax

#### Fringe Benefits Tax

- Announced 19 Sept 1985 → **came into effect 1 July 1986**
- Separate type of tax → imposed on provision of FB, not receipt of income
- Tax is imposed on the employer, not the employee
- Relevant legislation is the Fringe Benefits Tax Assessment Act 1986 (FBTAA)
- **NB: FBT Year = 1 April to 31 March**

#### Steps in Dealing with FBT

1. Identify whether a FB exists
2. Check whether it is excluded from the definition of FB
3. Identify the category of FB that applies
4. Check whether an exemption applies
5. Determine the taxable value
6. Check if there is a reduction in taxable value
7. Determine whether the FB is a Type 1 or Type 2 benefit
8. Calculate the FBs taxable amount
9. Calculate the FBT liability

#### Step 1: Identify Whether A FB Exists. Requirement s136(1):

- **A benefit** i.e. right, privilege, service or facility provided under an arrangement in relation to the performance of work (can be cash or non-cash)
- **Provided during the year of tax:** meaning of “provide” is given by the *Westpac Banking Corporation (1996)* case and *s148(3)(4)*, where the TP usually charged its customers a loan establishment fee when entering into a loan arrangement. However, the fee was waived in the case of loans made to employees. The TP argues that the definition required a positive act for a benefit to be “provided”. However, the court held that the non-imposition of a fee was “provided” a benefit to its employees in this case.
- **By an employer, associate or 3<sup>rd</sup> party:** Associates are defined in *s136(1)* refers to *s318 ITAA36* and *s159 FBTAA*. Relative is defined in *s995-1 ITAA97*.

The employer’s (“natural person”) associates include:

- Relatives
- A partner of the employer and their spouse or child
- A partnership in which the employer is or was a partner
- Trustees of trusts where the employer or the employer’s associates may be a beneficiary; and
- Companies formally or informally controlled by the employer (formal control refers to a majority voting power in the company while informal control refers to situations where the directors of a company usually act in accordance with the employer’s directions)

The employer’s (“company”) associates include:

- A partner (and their spouse or child if the partner is a natural person)
- A partnership in which the employer is or was a partner
- Companies which formally or informally control the employer
- Companies which are formally or informally controlled by the employer; and
- Sister companies (i.e. companies with the same parent company)

**NB:** FBs can be provided by an employer to an employee indirectly through 3<sup>rd</sup> party arrangements; however, the employer must “participate in or facilitate the provision of the receipt of the benefit” for the benefit to qualify as a FB.

Payne v FCT (1996) (employer paid the tickets; Payne paid the membership); TR 99/6: frequent flier points are not FBs when not provided by employer, associate or 3<sup>rd</sup> party.

- **To an employee or an associate**
  - An employee is some who receives salary and wages and includes current, former and future employees s136(1) FBTAA
  - Ruling MT 2016 confirms that a person will only qualify as a future employee if it can be said that they WILL (not may) become an employee at the time the benefit is provided.
  - A person will be **deemed to be an associate of the employee** where a benefit is provided to the person due to an arrangement between the employer and the employee s148(2). Though this person may not be an “associate” of the employee under the definition of an associate, they are deemed to be an associate as per s148(2) FBTAA
  
- **In respect of the employment of the employee**
  - The benefit must be provided ‘by reason of, by virtue of, or for or in relation, directly or indirectly to’ the employment: definition of ‘in respect of’ in s136(1)
  - ‘sufficient and material relationship’ between the employment and the provision of the benefit: J&G Knowles & Associates Pty Ltd (2000): loan made to directors in their capacity as directors and not employees, so NOT FB.
  - The ATO’s FBT: Guide for Employers (NAT 1054) suggest that you consider **whether or not the benefit would be provided if the person was not an employee?** If YES, NOT FB. If not clear, go back to the gift and income factors.
  - Ruling MT 2019: the ATO suggests that a benefit provided to an employee who is also a S/H will not constitute a FB if it is provided to the person solely because they are S/H.

## Step 2: Is It Excluded From Definition of FB Under s136(1)

- **Salary and wages s136(1)(f):**
  - Salary and wages comprise all amounts paid as a reward for services rendered by an employee: J Walter Thompson (Australia) Pty Ltd (1944).
  - The description of the payment is not determinative, and it is necessary to look at the substance of the payment to determine its character: Roads and Traffic Authority of New South Wales (1993); Ruling TR 92/15.
  - This extends to commissions, bonuses and allowances to employees, company directors and office holders; commonwealth education or training program; and compensation, sickness or accident payment.
  - Allowances are classified as salary and wages and thus excluded from FB, but reimbursements are not excluded from the definition of FB and are thus FBs.
- **Superannuation contributions**
- **Payments from superannuation funds**
- **Benefits under an employee share scheme**
- **Payments on termination of employment**

**Step 3: Which Category?**

- **Car FB: Div 2** – a car FB arises where an employer provides a car for an employee’s private use s7(1). As a general rule, Ruling MT 2027 travel between home and work is not in the course of producing AI and would constitute private use. It does not matter whether the employee actually uses the car for private purposes; a FB arises as long as the car is available for private use.
- **Debt waiver FB: Div 3** – arises where an employee owes an amount to an employer and the employee is released from this obligation to repay all or some of that amount s14 FBTAA. The debt must be waived due to the employment relationship and not for some other reason to constitute a debt waiver FB.
- **Loan FB: Div 4** – when an employer provides employee (or associate) with a loan s16 FBTAA.
- **Expense Payment FB: Div 5** – the employer pays an expense incurred by the employee, or where the employer reimburses an employee for expenditure incurred by the employee s20 FBTAA.
- **Free or subsidized housing: Div 6**
- **Living-away-from-home allowance: Div 7**
- **Discounted fares on airline transport: Div 8**
- **Free or subsidized board: Div 9**
- **Meal entertainment FB: Div 9A** – when an employer provides its employees with (1) entertainment by way of food or drink; (2) accommodation or travel in connection with entertainment by way of food or drink; or (3) a reimbursement of expenses incurred by an employee in relation to the above.
  - Food or drink must be provided as “entertainment”
  - Ruling TR 97/17: Factors in determining whether food or drink is entertainment: note first 2
  - Why the food is provided: food or drink provided as refreshment (morning tea) is not entertainment, but if social situation (lunch at a restaurant) is entertainment.
  - Type of food/drink: morning/afternoon tea, sandwiches, light meals are not entertainment, three course meal is entertainment.
  - When it is provided: if provided during work hours, during overtime or while an employee is travelling for work purposes is less likely to be entertainment; and
  - Where the food or drink is provided: at the employer’s premises is less likely to be entertainment but at a hotel, restaurant or café is more likely.
- **Tax-exempt body entertainment expenses: Div 10**
- **Car parking FB: Div 10A**
- **Property FB: Div 11** – arises where an employer provides an employee with property s40 FBTAA. Only arises where the property is given not just for use of the property which is captured by category like residual benefits. “Property” defined in s136(1) as tangible (goods: animals, fish, gas and electricity) and intangible property (real property: land and buildings; a chose in action: right to sue).
- **Residual benefits: Div 12** – a catch-all category to capture any benefits that do not fall into any of the other categories of FBs s45 FBTAA. E.g. provision of services for free/discount, provision of caravans at work sites for the accommodation of employees (RTA 1993) and waivers of loan establishment fees (*Westpac Banking Corporation 1996*).

**Step 4: Is It Exempt? (not subject to FBT, either apply to a category of FB or within Div 13 FTAA)****Loans**

- s17(1)(2) FBTAA: Loans made in the ordinary course of business on arm’s-length terms. A loan FB will be an exempt benefit where the loan is provided by a person who provides loans to the general public in the ordinary course of the business, and the loan to the employee is provided at an interest rate at least equal to the interest rate prevailing at that time on similar loans to the public. *Slade Bloodstock (2007)*

- s17(3) FBTAA: a loan FB is an exempt benefit where the loan is essentially an advance to the employee so that the employee can meet expenses that are reasonably expected to be incurred by the employee in the next six months in the course of performing his or her duties of employment. Usually when employee travels or moves for employment purposes and the employer gives a loan for this purpose.
- s17(4) FBTAA\*: a loan FB is an exempt benefit where the loan is provided to enable the employee to pay a rental bond, security deposit in respect of gas, electricity or telephone services or any similar amount. The employee must be required to repay the loan amount within 12 months, and the loan must be provided in conjunction with certain other FBs to be exempt.

### Property

- s41 FBTAA: a property FB is an exempt benefit where the property is provided to a current employee and is provided to and consumed by the employee on a working day and on the business premises of the employer or a related company (biscuits or fruits).

### Residual

- s47(2) FBTAA: recreational or childcare facility located on the employer's premises is exempt.
- s47(3) FBTAA: any private use of property located on the employer's premises is exempt benefit where the property is wholly or principally in connection with the operation of the business is exempt benefit include private phone calls or personal printing at the employer's premises.
- s47(4) FBTAA: "business operation facilities" is exempt benefits such as toilets, bathroom facilities, food or drink vending machines, tea or coffee machine, water dispensers etc.

### Listed in Division 13 FBTAA 'Miscellaneous Exempt Benefits'

- s53 FB related to the provision of a car fringe benefit i.e. car expense payment benefit
- s58P 'Minor benefits' (< \$300): a benefit will be exempt as a minor benefit where the notional TV of the benefit is less than \$300.
  - Notional TV is the TV of the FB as determined for each category of FB taking into account any reduction for recipient's contribution but not any reduction of TV due to the application of the otherwise deductible rule.
  - Not available for 'in-house FB' which is subject to a \$1000 reduction in taxable value for each employee (goods or services provided by the employer in the ordinary course of the business).
  - TR 2007/12 must be "unreasonable" to treat it as a FB i.e. Christmas gift, financial year-end dinner less than \$300, infrequent but regular benefits qualify as minor benefits. However, frequent and regular benefits not treated as minor benefits i.e. meal voucher for late work, usually work late at least once a month, though each benefit less than \$300, not minor benefit as frequent and regular so that cumulative value exceeds \$300.
- s58X Work-related items
  - s58X (2) these include portable electronic devices, item of computer software, protective clothing, briefcase, tools of trade. These items will only be eligible for exemption where they are primarily for use in the employee's employment.
  - ATO ID 2008/127: provision of laptop computer to an employee who regularly visits clients is primarily for use in the employee's employment.
- s58Y Membership fees and subscriptions:
  - Exempt benefits whether paid for directly by the employer or by way of reimbursement.
  - E.g. subscription to a trade or professional journal; entitlement to use a corporate credit card; and entitlement to use an airport lounge membership
- s58Z Single trip taxi travel beginning or ending at employee's place of work: not ride-share services

**Step 5: Calculate the Taxable Value**

**Car FB – either the *statutory formula method s9*; OR**

$$\left( 0.2 \times \text{Base value of the car} \times \frac{\text{Number of days during that year of tax on which the car fringe benefits were provided by the provider}}{\text{Number of days in that year of tax}} \right) - \text{Amount (if any) of the recipient's payment}$$

Base Value = Cost of Car; Recipients Payment = Insurance, Petrol, etc.

**The *operating cost method s10*:**  $TV = C \times (100\% - BP) - R$ ,

- where C = operating cost of the car during the holding period (petrol, lease payments, depreciation); BP = business use percentage of the car during the holding period; R = recipient's payment (if any)
- s10(5) FBTAA even if employer chose the higher one, the method which results in a lower TV would automatically apply.

**Debt Waiver FB:** s15 FBTAA Taxable amount is the amount of the debt that is waived during the year.

**Loan FB:**

s18:  $(\text{Benchmark Interest Rate} - \text{Actual Interest Rate}) \times \text{Loan Amount} \times (\text{Number of days loan provided during the year} / \text{Number of days in FBT year})$

- The idea is you are being taxed on the BENEFIT you receive from getting a loan from your employer (a lower interest rate and therefore lower interest)
- 1 April 2019 – 31 March 2020 Benchmark Interest Rate = 5.37%: TD 2019/6

**Expense Payment FB: in-house vs. external**

- s22A: In-house expense payment FB (what the employer sells in their ordinary course of business s136(1))  
→ look at property/residual benefit (anything not property, then residual) (i.e. assume employer did not reimburse the employee but provided the property or services directly)
- s23: External expense payment FB (not in-house i.e. children's school fees assume the employer is not the school) → amount of the expense/reimbursement

**Meal Entertainment FB:**

- Either the **50/50 split method** (apply automatically unless employer chooses the other s37B)
  - TV = 50% of all meal entertainment expenditure incurred by the employer during the FBT year in providing meal entertainment s37BA
- Or the **12-week Register method s37C**:
  - s37CB employer must maintain register of all meal entertainment expenditure over 12-week period & determine % that relates to provision of meal entertainment as FB [i.e. provided to employees/associates and not to others like clients]
  - TV = Total meal entertainment expenditure incurred in FBT year \* Register Percentage



**Property FB:**

- s42 in-house property FB: where the employer sells in their ordinary course of business s136(1)
  - Property is manufactured, produced, processed or treated by the provider: TV = lowest price (when sold in the ordinary course of business to manufacturers, wholesalers or retailers); or 75% of the lowest price charged to customers (when sold to the public); or 75% of the amount that could reasonably be paid to acquire the property from the provider in an arm's length transaction (in any other case)
  - Retailer: TV = the lower of arm's length cost and arm's length price (if the above does not apply and employer acquired the property)
  - Other Case: 75% of arm's length price
- S43 external property FB: TV = cost to the employer

**Residual FB:**

- ss48 & 49 in-house residual FB: where the employer sells in their ordinary course of business s136(1)
  - 75% of the lowest price charged to customers (when identical benefit sold)
  - 75% cost to acquire benefit from the provider in an arm's length transaction (in any other case)
- ss50 & 51 external residual FB: TV = the cost to the employer or expenditure incurred by the employer in providing the benefit.

**Step 6: Is There A Reduction to Taxable Value?**

- s62 in-house FBs: you can reduce the TV of all in-house expense, property or residual FBs by \$1000 for each employee as long as the FB is related to that person. NB: NOT on aggregate basis.
- Recipient's contribution: not for car, debt waiver and loan FBs as either not applicable or has been incorporated into the determination of TV at first instance.
  - If the recipient has paid any amount to the benefit, then that contribution amount will reduce the employer's TV.
  - ss22A(4) and 23 Any reimbursement to the employee does NOT count as their contribution.
- "Otherwise deductible rule": not applicable for car or debt waiver FBs. ONLY apply to the employee not associates of the employee i.e. the expense must have been deductible to the employee. The expense must give rise to a ONE-TIME-ONLY DEDUCTION i.e. depreciation not applicable.
  - TV of a FB is reduced by the amount which would have been deductible to the employee had the employee incurred an expense directly rather than received a FB.
  - E.g. employee received a loan FB of \$20k at 2.2% for a FB year, TV = \$600 i.e. the interest saved by obtaining a loan from employer not at commercial rates. Spent 1/3 on purchasing shares (otherwise deductible rule as interest incurred in acquiring an income-producing asset); spent 1/3 on personal credit card debt (private use not deductible) and spent 1/3 on purchasing shares in wife's name (not otherwise deductible as the interest expense is not deductible to the employee).

**Step 7: Type 1 or 2?**

- **Type 1 FB:** *ss5C(3) and 149A* the employer entitled to GST input tax credits (Topic 11)
- **Type 2 FB:** Employer NOT entitled to GST input tax credits
  - Loan and debt waiver FBs
  - Other GST-free supplies → i.e. international flights; school fees
  - Employer not registered for GST

**Step 8: Calculate the FBs Taxable Amount (1 April 2019 to 31 March 2020)**

- **Type 1 FB:** FB Taxable Amt = TV x 2.0802 (*s5B*)
- **Type 2 FB:** FB Taxable Amt = TV x 1.8868 (*s5B*)

**Step 9: Calculate the FBT Liability (1 April 2019 to 31 March 2020)**

- *s66*: FBT liability equals: FBs Taxable Amt x FBT rate (i.e. 47%)
- *s66*: FBT is imposed on the employer

**Interaction with Income Tax**

- FBs are NANE for employees
  - *s23L: ITAA36* NOT OI
  - *Note to s15-2 ITAA97*: NOT caught by s15-2
- Deductions for employer
  - Employer can claim a deduction for FBT under *s8-1* plus the cost of providing the FB
  - NB: *s32-20 ITAA97* non-deductible expenses