

Introductory Issues

WHAT IS TAX?

Definition of tax

A tax is a “compulsory contribution to the support of government, levied on persons, property, income, commodities, transactions, etc.” (Oxford English Dictionary)

There is usually no link between the amount of tax paid and the benefit to the taxpayer

Direct and indirect taxes

Direct taxes are taxes where the economic burden is borne by the person who pays the tax, such as income and capital gains tax

Indirect taxes are taxes where the person who pays the tax is able to pass the economic burden of the tax to third parties, such as GST, customs and excise duties

Proportional, progressive and regressive taxes

Proportional taxes are imposed at the same rate on all taxpayers (such as GST which is levied at a flat rate of 10%)

Progressive taxes are imposed at rates which increase with the tax base, such as income tax where the tax rate increases with the amount of taxable income.

Regressive taxes are imposed at rates which decrease with the tax base

FEATURES OF A GOOD TAX SYSTEM

Smith’s maxims

In his famous 1776 treatise, *The Wealth of Nations*, Adam Smith wrote of taxation that:

- the subject of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities;
- the tax payable by each individual must be certain and not arbitrary and the time of payment, the manner of payment, and the quantity to be paid ought to be clear and plain to the contributor and to every other person;
- every tax ought to be levied at the time, or in the manner in which it is most likely to be convenient for the contributor to pay it; and
- every tax ought to be contrived to take as little out of the pockets of people over and above what it brings in to the public treasury.

Features of a good tax system

1. Simplicity and certainty
2. Transparency
3. Low collection and compliance costs
4. Difficult to avoid or evade
5. Should be flexible (means having a broad tax base in order to cope with changing economic circumstances without disproportionately burdening specific persons)

6. Should be neutral (shouldn’t distort commercial decisions or market mechanism)
7. Equity (means that each taxpayer should pay their “fair share” of tax)
8. Harmony with policy objectives and social security systems

AUSTRALIA’S TAX SYSTEM

Legislative scheme

Due to the prohibition against tacking in *s 55 Commonwealth Constitution*, Australia’s tax scheme is **split into assessment, rates and administrative legislation** (although this is now otiose given the modern interpretation of *s 55* in *Permanent Trustee Australia v CSR*).

We have two *Income Tax Assessment Acts* because of the Tax Law Improvement Project which aimed to simplify the *ITAA 1936*, but was never completed.

- *Income Tax Assessment Act 1936*
- *Income Tax Assessment Act 1997*
- *Income Tax Rates Act 1986*
- *Taxation Administration Act 1953*

Features of the Income Tax Assessment Act 1997:

- robust numbering system which corresponds to Divisions;
- method statements (see for example: *s 4-15*);
- asterisks used to denote defined terms;
- explanatory guides before Divisions;
- diagrams (see for example: *s 6-1*);
- pyramid structure; and
- plain English.

ADMINISTRATIVE SYSTEM

Structure of the ATO

National office in Canberra and Branch offices in each State and Territory

Headed by Commissioner of Taxation and three Second Commissioners, appointed by the Governor General: *s 4 TAA*

Deputy Commissioners are appointed as required: *s 7 TAA*

Delegations and authorisations

Commissioner has general power of administration of the *TAA* and *ITAA*: *s 3A TAA* and *s 8 ITAA*

Power of Commissioner may be:

- Delegated – delegate can act in their own name; or
- Authorised – Person is authorised by delegate to exercise power in the delegate’s name.

The rulings system

Public rulings are made on matters of general tax interest; they are binding on the ATO if they are favourable to the taxpayer, but are not binding on the

taxpayer; they use a sequential numbering system (eg, TR 2011/2): Div 358 Sch 1 TAA

Private rulings apply only to the taxpayer for which they are issued and only to the facts as stated in the private ruling; redacted versions of all private rulings are published on the ATO website for transparency: Div 359 Sch 1 TAA

Income Tax: Types of income

ASSESSABLE INCOME

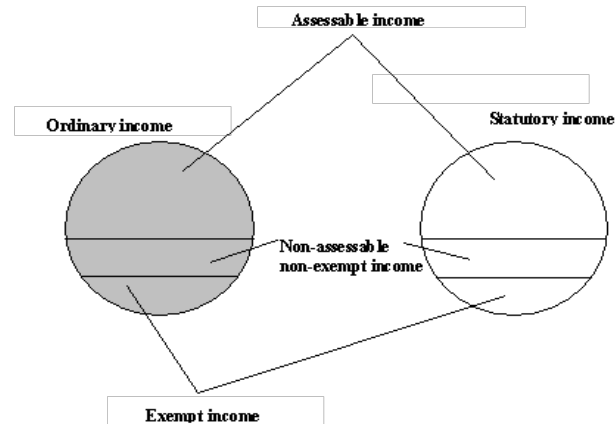
Meaning of assessable income

Assessable income consists of ordinary income and statutory income: s 6-1(1) ITAA 97

Some ordinary and some statutory income is exempt and not assessable: s 6-1(2) ITAA 97

Some ordinary and some statutory income is neither exempt nor assessable: s 6-1(4) ITAA 97

Assessable income: s 6-1 ITAA 1997



EXEMPT INCOME

Exempt income is not included in taxable income, but is counted in reducing prior year tax losses:

- entity itself can be exempt: s 11-5 ITAA 1997
- type of income may be considered exempt: s 11-10 ITAA 1997
- income derived from certain entities may be exempt: s 11-15 ITAA 1997

NON-ASSESSABLE NON-EXEMPT INCOME

Income can be non-assessable, non-exempt income: s 6-1(4) ITAA 1997

- Section 11-55 lists the non-assessable, non-exempt provisions (including FBT and GST)
- Division 59 details particular amounts

Non-assessable, non-exempt income is not used to calculate taxable income, but is counted in reducing prior year tax losses.

Income Tax: Residence

RESIDENCE GENERALLY

Importance of residence

Residents are assessed on their ordinary income and statutory income from **all sources**:

ss 6-5(2), 6-10(4) ITAA 1997

Foreign residents are assessed on their ordinary income and statutory income from **Australian sources**: ss 6-5(3)(a), 6-10(5)(a) ITAA 1997

Tests of residency

Individuals: s 6(1) ITAA 1936	Corporations: s 6(1) ITAA 1936
Common law "ordinary residence" test	Incorporation test
Domicile test	Central management and control test
183-day test	Control of voting power test
Commonwealth superannuation test	

RESIDENCE OF INDIVIDUALS

Common law test

Section 6(1) ITAA 1936

- "Resident means a person who resides in Australia"

Meaning of resides

Reside is not defined in legislation and takes its ordinary meaning: "to dwell permanently or for a considerable time, to have one's settled or usual abode, to live, in or at a particular place"

Relevant circumstances

The place where a person resides is a question of fact and degree: *FCT v Miller*

The following factors are relevant:

- period of physical presence in Australia: TR 98/17 at [18]
- The Commissioner considers 6 months spent in Australia to be a sufficient amount of time for the purposes of this test, but this is not determinative: TR 98/17 at [22]
- frequency, regularity and duration of visits
- intention and purpose of visit: TR 98/17 at [47]
- a settled purpose, such as employment or education supports the inference that the taxpayer resides in Australia: TR 98/17 at [48]
- if the intent is to stay less than 6 months but the stay extends beyond that, the taxpayer is considered a resident from their arrival: TR 98/17 at [25]
- maintenance of family ties: TR 98/17 at [52]
- In *Reid v IRC*, the fact the appellant had her family ties in England was a relevant factor in deciding she resided in England
- The presence or absence of a taxpayer's family does not necessarily mean that the taxpayer is or is not residing here: TR 98/17 at [52]; *Peel v IRC*

- maintenance of business/employment ties: *TR 98/17 at [55]*
- an individual who is dwelling in Australia for a considerable time while on an employment contract would be residing here: *TR 98/17 at [55]*
- the existence of an employment contract in the home country and an intention to resume that employment after leaving Australia is rarely a significant factor in determining whether an individual is residing here: *TR 98/17 at [56]*
- maintenance and location of the taxpayer's assets: *TR 98/17 at [57]*
- occupation of a dwelling that an individual owns or is purchasing is relevant as is ownership of motor vehicles and bank accounts in Australia: *TR 98/17 at [57]*
- social and living arrangements: *TR 98/17 at [59]*
- joining sporting or community organisations, enrolling children in school, redirecting mail to Australia or committing to a residential lease: *TR 98/17 at [59]*

Key cases

Levene v IRC:

Facts: Taxpayer had lived in London his whole life until 1919 when he left England under medical advice with the intention of living abroad. He returned to England for about 5 months each year until 1925 for the purpose of obtaining medical advice, visiting relatives, dealing with income tax affairs, and Jewish religious observances. He had no permanent residence until 1925 when he signed a nine year lease of a flat in Monte Carlo.

Decision: He was a resident of England until 1925 when he signed the lease because of the regularity of his visits, his ties with England, and the freedom of his attachments abroad.

Lysaght v IRC

Facts: Taxpayer was born in England and lived there until 1919 when he retired and moved to Ireland. He did consultancy work in England for one week per month and stayed in hotels or at his brother's house. He had bank accounts and family in both countries and a portfolio of securities with an Irish address. He was trying to sell his property in England.

Decision: He was a resident of England. The fact he had a home in Ireland and no established home in England was not incompatible with him being a resident of the United Kingdom because there was other evidence to support this conclusion.

Cooper v Cadwalader:

Facts: A barrister from the United States retained a property in Scotland. He spent two months a year at that property with his valet but had servants maintain the property in his absence.

Decision: He was a resident of the United Kingdom because he had a house there which was always available for his use, even though he spent the majority of his time abroad.

Domicile test

Section 6(1) ITAA 1936

"Resident includes a person whose domicile is in Australia, unless the Commissioner is satisfied that his permanent place of abode is outside Australia"

Element 1: "Person whose domicile is in Australia"

Three types of domicile:

- domicile of origin;
- domicile of choice; and
- domicile by operation of law.

A person acquires a "domicile of origin" at birth (father's domicile at birth) and maintains that until the person acquires a "domicile of choice" (by choosing to make another country his or her home) or otherwise acquires a "domicile by operation of law"

Element 2: "Permanent place of abode" is not outside Australia

Commissioner ruled in *IT 2650 at [27]* that:

- a person who intends to stay in a place for 2 years or more will have a permanent place of abode there;
- a person who intends to stay in a place for 2 years or less won't have a permanent place of abode there.
- Other relevant factors from *IT 2650 at [23]* include:
- the intended and actual length of the taxpayer's stay in the overseas country;
- acquisition of place of abode outside Australia and intention to make that place a 'home';
- abandonment of place of abode in Australia;
- duration and continuity of presence in the overseas country; and
- durability of association with a place (family and business ties).

Does not require an intention to move forever, but must not be transitory: *Applegate v FCT*

Applegate v FCT:

Facts: Sydney solicitor opened a new firm in Vila. He gave up his lease in Sydney and sold his assets but kept hospital cover and life insurance in Australia and intended to return at some undecided time in the future. He holidayed in Australia and his wife gave birth here. He returned to Australia earlier than planned due to sickness.

Decision: Permanent does not mean forever. He was not a resident of Australia because his permanent place of abode was Vila.

A stay for a fixed term may still constitute a permanent place of abode: *FCT v Jenkins*

Jenkins v FCT:

Facts: A banker had been transferred overseas for work for 3 years but he returned after 18 months due to illness. He was unable to sell his house in Australia so he rented it and funds went into an Australian bank account.

Decision: Court held that Jenkins did have a place of abode outside Australia even though he had an intention to return at a specified time.

183 day test (applies to arrivals in Australia, not departures)

Section 6(1) ITAA 1936

“Resident includes a person who has actually been in Australia, continuously or intermittently, during more than one-half of the year of income, unless the Commissioner is satisfied that his usual place of abode is outside Australia and that he does not intend to take up residence in Australia”

Elements

1. Must be in Australia for more than half the year; unless
2. Usual place of abode is outside Australia; and
3. No intention to take up residence here.

Application of the 183-day test

Does not apply where a former resident leaves Australia and is no longer a resident under the domicile test. The 183 day test is used to decide whether a person has commenced to reside in Australia, not whether they have ceased to reside here: *Case S19 at 232*.

“In Australia for more than half the year”

183 day period may be continuous or intermittent: s 6(1) ITAA 1936

183 day period must be within a **single financial year**: s 6(1) ITAA 1936

“Usual place of abode outside Australia”

Usual abode means something less than permanent residence and should be given its ordinary and natural meaning:

- **usual** means current, ordinary, customary; and
- **abode** means habitual residence, place of habitation, house or home.

“No Intention to take up residence here”

Intention to take up residence means to become a resident under immigration law: *IT 2650*

Superannuation test

Section 6(1) ITAA 1936

“Resident includes a person who is:

- a. a member of the superannuation scheme established by deed under the *Superannuation Act 1990*;

- b. an eligible employee for the purposes of the *Superannuation Act 1976*; or
- c. the spouse, or a child under 16, of a person covered by subparagraph (A) or (B) above”

Application of the superannuation test

This test covers, for example, Commonwealth public servants (such as foreign diplomats living abroad) as well as their spouses and children under 16.

DUAL RESIDENCE

Although it is technically possible for taxpayers to be resident in more than one jurisdiction (*Koitaki Para Rubber v FCT*), Australia’s Double Tax Agreements contain ‘tie-breaker rules’ that specify the country in which a ‘dual resident taxpayer’ will be deemed to be resident.

Income Tax: Source

SOURCE GENERALLY

Importance of source

Foreign residents are assessed on their ordinary income and their statutory income from Australian sources only: ss 6-5(3)(a), 6-10(5)(a) ITAA 1997

Determining source

The source of income is a question of fact: *Nathan v FCT*

Income from multiple sources

Where income is derived from multiple sources, it may be appropriate to apportion the income between the different sources: *CT (NSW) v Cam & Sons*

SALARY AND WAGES

General rule

The source of services income is generally the place where the services are performed:

CT (NSW) v Cam and Sons:

Facts: Men were employed on trawlers. Their employment engagement was entered into in NSW but some work was performed outside NSW territorial waters. Payment was made once the trawler returned to port in NSW.

Decision: Source of income was where the services were performed, that is, outside NSW territorial waters. As some of the work was performed within NSW, the income was apportioned accordingly.

FCT v Efstathakis:

Facts: A Greek national was employed by the Greek Government to work for the Greek Press and Information Service in Australia.

Decision: The source of income was Australia.