

## Statutory Interpretation

### Definitions

- Section 995-1(1), ITAA 97 is a general definition provision that should be used if you require a definition of any word used in the Act (in the ITAA 97 all defined words are identified with an “\*”, see s 6-1)
- Because the TLIP is still in progress some of the definitions contained in s 995-1(1) simply refer back to ITAA 36, s 6(1) which is the general definition section for the old Act.
- NB inclusive/exclusive definitions

### And/Or

- When reading definitions or other legislation that requires a number of steps and alternative actions, it is imperative that you clearly understand whether the requirements of the section are all included (i.e. *and*) or whether only one is required (i.e. *or*).
- Less confusion is likely with the ITAA 97 and the ‘and/or’ is stated at the end of each paragraph so that the reader is always aware of the relationship with other requirements of the section.

## Residence of taxpayer and source of income

### Residency

- Sections 6-5(2) & (3) and 6-10(4) and (5) distinguish between the assessable income of a resident and a non-resident. A resident of Australia is taxable on income from all sources whereas a non-resident is only taxed on income from Australian sources.

### Source

- Sections 6-5 and 6-10 provides that a resident taxpayer must pay tax on income from all sources, whilst a non-resident need only pay Australian tax on income with an Australian source. This makes it important to be able to identify the source of a non-resident’s income.

## TOPIC 2.1 - ASSESSABLE INCOME

### Assessable Income and Allowable Deductions

- Remember.... In summary, we will be concerned with the following relationships:
  - **Tax payable** = (Taxable income X Tax rate) – Tax offsets
  - and-
  - **Taxable income** = **Assessable income** – **Allowable deductions**
    - ➔ If a taxpayer receives ‘assessable income’ that amount may be taxable – the taxable portion of that amount can be REDUCED by any DEDUCTIONS which the taxpayer can claim. If, after the deductions are applied, there is a remaining amount of ‘assessable income’ then that excess amount is TAXABLE INCOME
- **We need to be able to determine *assessable income* in order to be able to calculate taxable income**

- **Ordinary income** → pre-requisites: personal services, property and business
  - **Personal services** – salary/wage e.g. where you provide a service/job and are ‘awarded’ for it
  - **Property** – income from using property e.g. rent from an investment property, dividends from shares b/c exploiting the property for an income
  - **Business** – e.g. buying items from second-hand stores, fixing them up and on-selling them, this generates an income which means it is a business which is taxable
- **Statutory income**

## The income tax equation

### 4-15 How to work out your taxable income

(1) Work out your **taxable income** for the income year like this:

$$\text{Taxable income} = \text{Assessable income} - \text{Deductions}$$

#### *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.

## Assessable Income Defined

- There is no definition of ‘assessable income’ in s 6(1) ITAA 1997. Assessable income is made up of statutory income and ordinary income
- 6-1 ITAA97
  - 1) Assessable income consists of **ordinary income** and **statutory income**.
  - 2) Some ordinary income, and some statutory income, is **exempt income**.
  - 3) Exempt income is not assessable income.
- We therefore need to consider the meaning of ordinary income, statutory income and exempt income
  - **Ordinary income** is ‘income according to ordinary concepts and is assessable under **s 6-5 ITAA97**
    - A gain that is ordinary income will be assessable, unless the legislation explicitly states that it is not assessable
    - If the gain is *not* OI, it is assessable only if it is **statutory income**
  - **Statutory income** are gains which are not ‘ordinary income’ but made assessable by way of statute under **s 6-10 ITAA97**
    - **Division 10** lists specific types of statutory income

- OI or statutory income may be **EXEMPT** by statute or commonwealth law under **s 6-20(1) IITAA97**
  - Entities are exempt (s 11-5, 50-5 – 50-45)
  - Education scholarships (s 11-15)
  - Income derived from certain entities (s 11-15)

## INTERPRETATION

### Ordinary Income

- **S 6-5** defines ordinary income as *'income according to ordinary concepts'*
- Prior to the enactment of ITAA 97, the ITAA 36 used the term *gross income* in s. 25(1) which has now been redrafted in s. 6-5 as *income according to ordinary concepts*
- Courts have not offered an explicit definition, but rather identified characteristics which they say are attributable to receipts that are income in nature
  - Not necessary that all characteristics are satisfied in order to find that a gain is to be treated as OI
  - NOTE – if the prerequisites of income are satisfied, it is also necessary to determine whether the gain has the characteristics of income
- The failure to provide a concrete definition stems from the belief that the notion of income is not a technical term and hence **should simply be accorded its ordinary meaning** (*Scott v C of T (NSW) (1935) SR (NSW) 215 at 219, 3 ATD 142 at 144*)
- Receipts that are ordinary income can include:
  - Regular salaries and wages
  - Interest on investments
  - Dividends and rent
- Income is:
  - Gain
  - Money or monies worth
  - Regular
  - Reward for services (personal exertion)
  - Return from capital and labour (business)
  - Return from investment (property)
- What is NOT OI?
  - What is not ordinary income:
  - Capital receipts
  - Gifts
  - Chance winnings
  - Income from recreational activities
  - Non-cash receipts

## Operative provisions

### 6-5 Income according to ordinary concepts (*ordinary income*)

- (1) Your **assessable income** includes income according to ordinary concepts, which is called **ordinary income**.  
Note: Some of the provisions about assessable income listed in section 10-5 may affect the treatment of ordinary income.
- (2) 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.
- (3) 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.
- (4) In working out 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 or as you direct.

### Principles of interpretation that apply:

- To be treated as income must be determined in accordance with **ordinary concepts and usages of mankind**, except in so far as statute dictates otherwise (*Scott v FC of T* (1935))
  - Money/money worth
  - Earn it/reward service
  - Regular/repetitive
  - Expected/relied upon
  - Real gain
- Whether the payment received is income depends on a close examination of all relevant circumstances (*The Squatting Investment Co Ltd. v FC of Tax* (1953))
- It is an objective test (*Hayes v FC of T* (1956))

### PREREQUISITES & CHARACTERISTICS

#### What the courts have said about ordinary income: STEP 1

- 1) That the gain must either be **cash or cash convertible**. *Did the taxpayer receive money or something which is capable of being converted into money?* ***Federal Coke Co. Pty Ltd v. FCT* (1977) 7 ATR 515; *Cooke & Sherden* (1980)** and
- 2) That there must be a **real gain**. *Did the taxpayer realise an actual gain, that placed them better off financially?* ***Hochstrasser v. Mayes* [1960] AC 376**. This prerequisite is mostly applied to employment situations.

## CASH OR CASH CONVERTIBLE

- **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. The implication is that if some goods or services are received that cannot be converted to cash then there is no benefit to the taxpayer and therefore no ordinary income.
- This principle is discussed in **FCT v Cooke and Sherden ((1980) 10 ATR 696; 80 ATC 4140)** where it was held that amounts that cannot be converted to cash are not income in ordinary concepts, and s 21 of the Act could not give a money value where the non-monetary consideration could not be converted into cash or the right transferred to a third party.
  - Jewellery/car → can sell it
  - Can you put it on ebay?

### **FCT v Cooke and Sherden (1980)** → receipt of non-cash-convertible holiday (not OI)

- TP was a retailer, sold drinks door to door.
- The TP received a free holiday arrangement from the soft drink manufacturer as a result of them selling a certain number of drinks.
- The holidays were non transferrable and so could not be sold for cash
- To qualify as OI, must satisfy the definition of cash/cash convertible
- HELD - NOT OI because they were not cash convertible
- While the award would have saved the taxpayer from the expense of a holiday expense (e.g. money flowing/going out) it was not a gain that was received by the taxpayer (e.g. flowing/coming in)
- Note - FFC followed the principle in the case of **Tennant v Smith (1892)** that because holidays not cash convertible could not be ordinary income.

### **Tennant v Smith [1892] AC 150**

- The TP was an agent for a bank and lived in free accommodation supplied by the bank. The TP was not allowed to sublet the accommodation → t/f could not convert what he was receiving into cash
- Neither cash nor cash convertible. Not OI.

### **Payne (1996)** → FF points and free flights as a result were not OI (non cash benefit)

- Janet Payne travelled regularly as a result of her employment with a large accounting firm.
- Flights paid for by employer as they related to business. She was offered to join FF program on one of these trips and she signed up and paid the fee.
- She accumulated a lot of points over next few years, most resulting from business travel (minor part was private 3%).
- FC held that the free flights earned were not OI.
- The reason was that the tickets were not money or money worth and they could only be used by the program member or his or her nominee.
- They could not be sold in any way or converted to money so they were not cash or cash convertible.

## REAL GAIN

- E.G. **employee situation** - taxpayer incurs work-related expense/loss, but gets a reimbursement from its employer to cover that expense/loss. The

reimbursement is not income, since T is not *better off* financially. T is placed back in the same position prior to having incurred the expense/loss

**Hochstrasser v Mayes [1960] AC 376** → Reimbursement for work-related expense when moving cities is not assessable, not a real gain and t/f does not constitute ordinary income

- TP employer required him to move cities for work, and sold house at a loss
- TP sold his house in city he was leaving and received less than he had paid for it. The employer reimbursed him for the loss.
- House of Lords held NOT assessable
- It was not a real gain because he had just been compensated for work related expense. T was not better off → reimbursement for work-related lost placed him in the same position
- What if it was not work related? Receipt then would have been a real gain – if T was reimbursed for a private expense, that would be an additional benefit on top of wages, resulting in an actual gain from employer
- **MUST BE REAL GAIN AND NOT JUST A REIMBURSEMENT**

### REAL GAIN

- E.G. **clubs/association situation** – if taxpayer pays a fee to club and gets something of equivalent value (membership) then not financially better off, there was a mutual exchange of benefits
  - **Bohemians Club v Acting FCT (1918)** – TP, a club member, pays funds to a club/association. Club refunds fees back to T. TP did not gain anything, merely got a refund and not financially better off.
  - **RACV v FCT (1973)** – Club gave services to both members and non-members, and so non-members were gaining and this was income?

### **FURTHER CHARACTERISTICS OF ORDINARY INCOME – NEXT STEP**

- Having satisfied the prerequisites, what characteristics could indicate the gain was OI?
- Does the monetary gain have an ‘earning source’ from which it **flows**?
- A gain that is **regular/periodic** is more likely to be ordinary income than a lump sum; and;
  - **FCT v Dixon (1952)** – Court relied on periodic nature of payments to find that payments were income in ordinary concepts
  - **FCT V Blake (1984)** – Regularity encouraged the conclusion that a series of regular subsidies paid to a former employee to compensate for the effect of inflation on his pension were income, even though there was no obligation of the bank to pay
  - **FCT V Harris (1980)** – once-off lump sum is more likely to be treated as a gratuity or capital in nature
    - *NOTE – periodic payment received as payment for the sale of a capital item will remain capital even though they are regular AND one-off payments for provision of services can still be OI even if not regular*
- If something “**flows**” it is more likely to be ordinary income
  - Courts have used analogies with fruits and trees to illustrate this concept: **Eisner v. Macomber (1920) 252 US 189**.