

PART 1 – Exam Notes

TOPIC OVERVIEW

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Is the Plaintiff an Individual or Business Tax Resident?

1. **Is [plaintiff] an Australian resident for taxation purposes?**
 - a. **State:** If [Plaintiff] is an Australian Tax Resident, they will be taxed domestically on all sources of income from both within and outside of Australia. However, if they are not a tax resident, then they will only be taxed on Australian-sourced income. ss 6-5, 6-10 ITAA 1997.
2. **If plaintiff is an individual:**
 - a. **State:** There are four tests for determining the tax residency status of an individual. Only one has to apply for [plaintiff] to be taxed as a resident: s 6(1) ITAA36.
 - b. **Test 1 – The Resides test:**
 - i. The taxpayer will be resident if they reside in Australia.
 - a. The ATO has ruled that 2 elements should take presidency when determining residency. (TR 98/17):
 - i. Physical presence (most important); as supported by *FCT v Applegate*
 1. **NOTE:** 6 months is a considerable time. - TR 98/17
 - ii. The person's behaviour while in Australia. - *Rogers v IRC*
 1. Have they rented a nice a house?
 2. Is their family here?
 3. Any Leisure activities in spare time? (*Levene v IRC*).
 - a. **Test 2 – The Domicile test**
 - a. **OPTION 1: Domicile of origin:** the domicile of the person's father at the date of the person's birth. A person retains their domicile of origin until they acquire a domicile of choice: *Bell v Kennedy* (1868) LR 1 Sc & Div 307 (HL).
 - b. **OPTION 2: Domicile of choice:** demonstrated by the person's intention to make his/her home indefinitely in that country: Domicile Act 1982 s 10.
 - c. **Note:** General rule is that if a taxpayer leaves Australia and intends to return within 2 years, then they will not have a permanent place of abode overseas, but if they plan to be absent for more than 2 years they will have a permanent place of abode overseas: - TR IT 2650
 - d. **State:** The commissioner must be satisfied that permanent place of abode is not overseas. He must consider:
 - i. Intention as to length of stay:
 1. *FCT v Jenkins* (intended 3 years, actually stayed o/seas for 18 months HELD: Not resident.
 2. *Applegate* (intended to return to Australia at some faraway point) HELD: Not resident
 - ii. Abandonment of place of abode in Australia:
 1. *FCT v Jenkins; Re Mayhew v FCT*
 - iii. Durability of association (ties) with Australia
 1. (own / lease / family / children at school / employment / bank accounts): - Case Q68 (O/seas for 2 years in house provided by work HELD: Still an AA Resident due to lack of association overseas).
 - b. **Test 3 – the 183 Day Rule**

- i. **State:** If the taxpayer is physically present in Australia for more than half the income year, whether continuously or with breaks, they may be said to have a constructive residence in Australia. - Wilkie v IRC
 - a. **Exception:** Rule does not apply if it can be established that the taxpayer's usual place of abode is outside Australia and they have no intention of taking up residence in Australia.
 - i. This rule applies only where the other ordinary concepts tests of residency do not apply: Case 519
 - b. **Note:** The Commissioner must be satisfied that both:
 - i. The person's usual place of abode if not outside of Australia, and
 - ii. The person does not intend to take up residence in Australia.
 - c. **Test 4 – The Superannuation Test**
 - d. **State:** Per s 6(1)(a) (iii), a person is a resident if he/she is a member of the superannuation scheme for Commonwealth public servants. This test ensures that Australian government employees working at Australian posts overseas are treated as Australian residents
- 3. If plaintiff is a Company:**
- a. **State:** There are three alternative tests for establishing residence status of a company (only one has to apply): s 6(1) ITAA36.
 - a. **Test 1 – Incorporation Test**
 - a. A company which is incorporated in Australia in accordance with the Corporations Act 2001 (Cth) will be a resident company for tax purposes.
 - b. **Test 2 - Central management and control test**
 - a. **State:** A company will be a resident company for tax purposes if it carries on business in Australia and its central management and control are in Australia. (Malayan Shipping Co Ltd v FCT)
 - b. Central management and control refers to:
 - Where the directors meet to do business (Koitaki Para Rubber Estates Ltd v FCT) is generally the most important factor
 - Where the real business decisions are undertaken (North Australian Pastoral Co Ltd v FCT)
 - Contrast Unit Construction Co Ltd v Bullock and Esquire Nominees v FCT. In former, parent company was making all decisions in the UK, in latter accountants were merely advising directors from Australia. HELD: Resident in first, not resident in second.
 - c. **Test 3 – Shareholder Test**
 - a. **State:** A company will be a resident company if it carries on business in Australia and it is controlled by shareholders who are residents of Australia.
 - b. **Note:** "carry on business" means the day-to-day business, rather than the management powers.
 - c. Controlling power is more than 50% of the voting power at general meetings
 - d. Residents of the shareholders is determined according to the individual rules above.
- 4. If Plaintiff is not an Australian Tax Resident as above:**
- a. **State:** Non-residents are taxed only on Australian-sourced income per ss 6-5, 6-10 ITAA 1997
 - b. **State:** 'Source' is not defined in the ITAA36 or ITAA97, so the courts have developed principles for determining if it is sourced from Australia.

c. Income from personal Services

a. Relevant factors:

- i. Where the services are rendered (ordinarily sufficient to determine source): FCT v French
- ii. Where the contract is negotiated and made (if an artisan): FCT v Mitchum
- iii. Where payment is made (if an artisan/actor/consultant/expert): FCT v Mitchum

b. Business income

- i. General rule: the source of business income is where the trading activities take place: Commissioner v Meeks.
- ii. There are no clear rules about apportionment, though it may be required where activities are conducted across a number of countries: FCT v Lewis Berger & Sons; FCT v Angliss & Co Pty Ltd (HC apportioned according to value added at various stages of production).

c. Sale of Property

- i. Real property: the source is its location, since it is immovable: Rhodesia Metals Ltd (in liq) v Commissioner
- ii. Personal property: (e.g. ships) the hiring agreement is the essence of the arrangement so the location of the execution of that agreement will generally be the source.

d. Interest Income

- i. **Crucial factor:** Where the loan contract is negotiated and made: Commissioner for Inland Revenue v Lever Bros and Unilever Ltd; FCT v Spotless

e. Dividend Income

- i. **General rule:** the source of dividend income is where the profits were made by the company paying dividends: Esquire Nominees v FCT
- ii. For an investment company: the source is where the company is centrally managed and controlled and where decisions are made: Esquire Nominees v FCT

f. Royalties

- i. **Rule:** the source of income from royalties is determined by the location of the 'know how': United Aircraft

Is the Receipt Ordinary Income?

Note: s 6-1 ITAA 1997, states that ASSESSABLE INCOME = ORDINARY INCOME (s 6-5) + STATUTORY INCOME (s 6-10).

1. First Issue: Is the receipt ordinary income (s 6-5)?

a. Ordinary income must be derived:

- i. During the income year: ITAA 1997, ss 6-5(2) and
- ii. Must be convertible into money: FCT v Cooke (holiday is not); Payne v FCT (frequent flier points are not).

Note: IF BUSINESS: s 21A - Non-cash business benefits are treated as being convertible to cash. Must calc (Mkt Value – amount paid) to determine benefit.

b. **If relevant:**

- Principle of mutuality: Mutual receipts are not income. - Bohemians Club v Acting FCT (refund of membership fees to members is not ord. inc)

2. Is the income from physical exertion/employment/gift? (ordinary)

a. Factors to determine whether gains from personal services or gifts are ordinary income:

iii. Degree of connection to employment or services rendered (nature of the receipt) Dixon; Hayes; Scott. - Is the receipt, directly, incidentally, or not related to employment?

iv. Directly related to employment will be ordinary income (salary): *British Columbia*

v. If it is a bonus it will be ordinary income (*Brent*)

vi. Incidental to employment will be ord. income: Kelly v FCT (TV best an fairest award for footy player)

CONTRAST with Scott v FCT (former lawyer got a gift for good work HELD: not income because unrelated to employment)

vii. Dependence upon payment to meet usual living expenses: Blake

viii. Payment replaces income: Reuter; Dixon

ix. Motive of the payer or donor (commercial considerations / personal reasons?): Hayes; Scott; Blake

x. Whether payments are periodical, recurrent and regular: Dixon; Blake

b. **Contrast: windfall gains** (generally not ord. income)

xi. Gifts are, prima facie, not income – unless they are regular or directly related to income-earning activities or business activities: Hayes v FCT (gift to former employee not ord. inc)

FCT v Blake (regular gifts from former employer HELD: Income)

Scott v FCT (lawyer got one off gift after years of good work HELD: not income)

xii. Gambling winnings and lottery winnings are not income because they are usually lump sum payments, isolated and unexpected and have a degree of chance attached to them

3. Is the income from Property rent/royalty/interest from a loan? (ordinary)

a. Periodical gains from the use of property have the character of ord. income: s 6-5; FCT v Montgomery; FCT v McNeil; Citibank

b. **Note:** Royalties will be ordinary income if plaintiff is the owner of the patent/property.

4. Is the income from property sale?

a. Gains from the sale of property are generally capital in nature: Scottish Australian Mining Co Ltd v FCT (land bought to mine, but later subdivided and sold. Held: not income, merely a realisation of a capital asset)

b. **HOWEVER** they may have the character of income in either of these situations: