Income Tax Law

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Calculating Income Tax Payable / Refundable

Who Must Pay Income Tax?

4-1 Who must pay income tax

- Income tax is payable by each individual and company, and by some other entities.
- Note: The actual amount of income tax payable may be nil. For a list of the entities that must pay income tax, see Division 9, starting at section 9-1.

Determining the Tax Payer Entity

9-1 List of entities

- Income tax is payable by the entities listed in the table.
- The tax entities listed include:
  - An individual: s4-1.
  - A company, that is a body corporate; or an unincorporated body (except a partnership): s4-1.
  - A corporate limited partnership: s94J.
  - A trustee (except one covered by a later item), but only in respect of some kinds of income of the trust: s98, s99, s99A & s102.
  - The trustee of a corporate unit trust: s102K.
  - The trustee of a public trading trust: s102S.

Definition of 'Individual'

s 995-1 → "A natural person".

The Income Tax Equation

4-10 How to work out how much income tax you must pay

(1) You must pay income tax for each *financial year.

(2) Your income tax is worked out by reference to your taxable income for the *income year*. The income year is the same as the *financial year, except in these cases:

(a) for a company, the income year is the previous financial year;

(b) if you have an accounting period that is not the same as the financial year, each such accounting period or, for a company, each previous accounting period is an income year. ...

(3) Work out your income tax for the *financial year as follows:

Income Tax = (Taxable Income x Rate) – Tax Offsets

Calculating Taxable Income

4-15 How to work out your taxable income

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

Taxable Income = Assessable Income – Deductions

- Assessable Income = Ordinary Income + Statutory Income
- Deductions = Generation Deductions + Specific Deductions

Assessable Income

→ s 6-1 refers to the different types of income and provides a relationship diagram.
→ s 6-5 refers to income according to ordinary concepts.
→ s 6-10 refers to statutory income.
→ s 6-15 refers to exempt income.
→ s 6-23 refers to non-assessable non-exempt income.
→ s 6-25 refers to income that cannot be double counted.

Ordinary Income

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

(1) Your *assessable income* includes income according to ordinary concepts, which is called *ordinary income*.

What is ordinary income?

- Income from personal exertion;
- Income from business;
- Income from property;
- Profits from isolated (singular) transactions;
- Miscellaneous types of receipts.

Statutory Income

6-10 Other assessable income (statutory income)

(1) Your assessable income also includes some amounts that are not * ordinary income.
Note: These are included by provisions about assessable income. For a summary list of these provisions, see section 10-5.

(2) Amounts that are not * ordinary income, but are included in your assessable income by provisions about assessable income, are called statutory income.

Deductions (Non-Assessable Income)

→ s 8-1 refers to general deductions.
→ s 8-5 refers to specific deductions.

→ s 8-10 no double deductions are permitted.

General Deductions

8-1 General deductions

(1) You can deduct from your assessable income any loss or outgoing to the extent that:
  (a) it is incurred in gaining or producing your assessable income; or
  (b) it is necessarily incurred in carrying on a *business for the purpose of gaining or producing your assessable income.
(2) However, you cannot deduct a loss or outgoing under this section to the extent that:
  (a) it is a loss or outgoing of capital, or of a capital nature; or
  (b) it is a loss or outgoing of a private or domestic nature; or
  (c) it is incurred in relation to gaining or producing your *exempt income or your *non-assessable non-exempt income; or
  (d) a provision of this Act prevents you from deducting it.
(3) A loss or outgoing that you can deduct under this section is called a general deduction.

Specific Deductions

8-5 Specific deductions

(1) You can also deduct from your assessable income an amount that a provision of this Act (outside this Division) allows you to deduct.
(2) Some provisions of this Act prevent you from deducting an amount that you could otherwise deduct, or limit the amount you can deduct.
(3) An amount that you can deduct under a provision of this Act (outside this Division) is called a specific deduction.

For a summary list of provisions about deductions, see section 12-5.

Calculating Income Tax Liability

4-10 How to work out how much income tax you must pay

(1) Work out your income tax for the *financial year as follows:

Income Tax = (Taxable Income x Rate) – Tax Offsets

- ✧ Income Tax Rates Act 1986 (Cth)
- ✧ Tax rates for resident taxpayers
- ✧ Tax rates for non-resident taxpayers
- ✧ Penal rates for minors

NOTE: Income tax is also known as tax liability.

Basic Income Tax Liability

Step 2: Work out your basic income tax liability on your taxable income using:
(a) the income tax rate or rates that apply to you for the income year; and
(b) any special provisions that apply to working out that liability.
See the Income Tax Rates Act 1986 and section 4-25.

Individual Resident Income Tax Rates for 2020-2021

Taxable Income	Tax on this income
$0 - $18,200	Nil
$18,201 - $45,000	19 cents for each $1 over $18,200
$45,001 - $120,000	$5,092 plus 32.5 cents for each dollar over $45,000
$120,001 - $180,000	$29,467 plus 37 cents for each dollar over $120,000
$180,001 and over	$51,667 plus 45 cents for each dollar over $180,000

- Does not include the Medicare levy of 2% of taxable income, subject to the low income thresholds.
- Does not include the Medicare levy surcharge for persons without private health insurance.

Tax Offsets

- Tax offset has the meaning given by s 4-10. A tax offset can be used to reduce the taxpayer's basic tax liability.
- NOTE: The Low Income Tax Offset and Low and Middle Income Tax offset can only reduce tax payable to Nil. They cannot create a tax loss.
- Section 13-1 ITAA 1997 lists the tax offsets. The two main offsets for individuals are;
  - The low income tax offset; and

Taxable income	Tax offset
Up to $37,500	$700
$37,501 to $45,000	$700 – (5% of excess over $37,500)
$45,001 to $66,667	$325 – (1.5% of excess over $45,000)
$66,668 and above	Nil

  - The low and middle income tax offset.

Low and middle income tax offset	
Taxable income	Offset
$37,000 or less	$255
Between $37,001 and $48,000	$255 plus 7.5 cents for every dollar above $37,000, up to a maximum of $1,080
Between $48,001 and $90,000	$1,080
Between $90,001 and $126,000	$1,080 minus 3 cents for every dollar of the amount above $90,000

Calculating Tax Payable / Refundable

After calculating **actual income tax liability** for the financial year, calculate **income tax payable/refundable** by:

1. ADD the 2% Medicare levy:
   - Calculated as = Taxable Income x 2% IF taxable income is:
     - < **$22,801** – no Medicare Levy is payable
     - > **$28,502** – the full 2% Medicare Levy is payable, and
2. ADD HELP Assessment DEBT (not expense) (if applicable):
   - 2020-21 Repayment Thresholds and Rates:

Repayment income (RI)	Repayment rate
Below $46,620	Nil
$46,620 - $53,826	1.0%
$53,827 - $57,055	2.0%
$57,056 - $60,479	2.5%
$60,480 - $64,108	3.0%
$64,109 - $67,954	3.5%
$67,955 - $72,031	4.0%
$72,032 - $76,354	4.5%
$76,355 - $80,935	5.0%
$80,936 - $85,792	5.5%
$85,793 - $90,939	6.0%
$90,940 - $96,396	6.5%
$96,397 - $102,179	7.0%
$102,180 - $108,309	7.5%
$108,310 - $114,707	8.0%
$114,708 - $121,698	8.5%
$121,699 - $128,999	9.0%
$129,000 - $136,739	9.5%
$136,740 and above	10%

   - Note: This is for a DEBT. If it has already been paid up front as an expense, it cannot be included in tax payable / refundable.
3. DEDUCT any PAYG withholding tax or PAYG instalment credits (taxation credits) made equals taxable income.
   - Note: The Taxation Administration Act 1953, Part IIB Division 3A deals with refunds of surpluses and credits. The Commissioner is required to apply credits to taxation debts and refund the balance owing.
4. DEDUCT any TFN withholding tax.
5. REFUND due or balance owing to the ATO.

If a positive figure = Tax Payable.
If a negative figure = Tax Refundable.

Example

Tanya, a single resident, earns $90,000 in wages in the current tax year and her employer deducts $13,500 in PAYG withholding tax deductions. She has $15,500 in deductions and is entitled to a middle-income tax offset of $1080. She has private basic hospital insurance cover during the income year. The current tax year is the income year ended 30 June 2021.

Taxable income = (90,000 – 15,500)	$74,500.00
Income tax	$14,659.50*
less tax offset	$1080.00
+ Medicare levy 2% × $74,500	$1490.00
Actual income tax liability	$15,069.50
less PAYG tax instalment deductions	$13,500.00
Income tax payable	$1,569.50

*$5,092 + [($74,500 – $45,000) × 32.5%] = $14,659.50

Relationships Among Various Rules About Ordinary Income

ITAA 1997

This Act contains some specific provisions about how far the rules about ordinary income prevail over the other provisions of this Act.

→ 8-1 General deductions
→ 8-5 Specific deductions
→ 8-10 No double deductions

- General rule – Statutory Income provisions prevail over Ordinary Income.
  - Exception - if the Statutory Income provisions express a contrary intention so that s6-5 applies instead.
    - For example: s 15-2(3)(d), s 15-10(b), s 15-15(2)(a), s 15-20, s 15-25(d), s 15-30(b) & s 118-20(1)(a).

- Problem solving process:
  1. Consider which Statutory Income provisions are applicable first as these will generally apply because they prevail over Ordinary Income in s 6-5.
  2. If the Statutory Income provision expresses a contrary intention so that s 6-5 prevails, then you must consider the operation of Ordinary Income in s 6-5.
  3. If there is no contrary intention in Statutory Income provision and certain that it applies, then no need to consider Ordinary Income in s6-5.

Definition of 'Carrying on a Business'

✧ Definition of "business": s995-1(1).
  - Includes "any profession, trade, employment, vocation or calling, but does not include occupation as an employee".

✧ "Carrying on a business" is not defined (pg. 187-188 Australian Tax 2021).

✧ Tax law concepts determined as a "question of fact".

Eight factors established in *Ferguson v Federal Commissioner of Taxation* in determining whether one is 'carrying on a business' (see below for further detail):

1. Nature of the activities;
2. Profit making purpose;
3. Profit is made from the activities;
4. Repetition and regularity of activities;
5. Organisation of activities in a business-like manner;
6. Time engaged in activities;
7. Volume of operations - time and scale;
8. Amount of capital used.

Also Consider: TR 97/11 states at para 13 that the courts have held that the following indicators are relevant when carrying on a business:

- "whether the activity has a significant commercial purpose or character; this indicator comprises many aspects of the other indicators;
- whether the taxpayer has more than just an intention to engage in business;
- whether the taxpayer has a purpose of profit as well as a prospect of profit from the activity;
- whether there is repetition and regularity of the activity;
- whether the activity is of the same kind and carried on in a similar manner to that of the ordinary trade in that line of business;
- whether the activity is planned, organised and carried on in a businesslike manner such that it is directed at making a profit;
- the size, scale and permanency of the activity; and
- whether the activity is better described as a hobby, a form of recreation or a sporting activity".

Ferguson v Federal Commissioner of Taxation

Facts:

- The taxpayer (a naval officer) entered into two agreements, one providing for the sub-lease of five cattle and the other providing for the agistment of the cattle.
- The intention was that the cattle would be employed in a breeding programme whereby female calves would be retained and used to establish the nucleus of a herd which the taxpayer would transfer to the grazing property he would acquire upon his retirement.

Held:

- The Federal Court observed that activities in advance of carrying out the ultimate intention of establishing a cattle production business on the taxpayer's own property may have such a commercial character as to amount to trading operations and, on this basis, the Court found that the taxpayer's activities in building up a herd were conducted in such a systematic and business-like manner as to amount to the carrying on of a business.
- Bowen CJ and Franki J, in their joint judgment, commented on the following factors which could be relevant when determining whether a business of primary production is being carried on:
  - Nature of the activities.
  - A profit-making purpose may be significant but an immediate profit-making purpose does not appear to be essential (the taxpayer may be trading at a loss in the short-term but as long as a long term profit making intention is present);
  - Repetition and regularity of activities. However, isolated activities carried out in the initial phases of a business will not preclude a finding that a business is being carried on;
  - Organisation of activities in a business-like manner, keeping of books, records and the use of a system;
  - Volume of activities and amount of capital employed; Ferguson maintained an index system of each animal's details for breeding purposes;
  - Concurrent activities. Even if a taxpayer carries on a profession or has already established a business it may be concluded that additional activities which are undertaken amount to a carrying on of a business;
  - Whether the activities can be described as the pursuit of a hobby or recreation or an addiction to sport. Clearly, activities pursued on this basis cannot amount to the carrying on of a business.

International Tax

Residence

Importance of Residence

- **Residents** are taxed on their worldwide income, they are taxed on all sources of income, within and outside of Australia: ss 6-5, 6-10 ITAA 1997.
- **Non-residents** are taxed only on Australian-sourced income: ss 6-5, 6-10 ITAA 1997.

Definition of Australian Resident

- **Australian resident** means a person who is a resident of Australia for the purposes of the Income Tax Assessment Act 1936: s995-1(1).
- **Foreign resident means** a person who is not a resident of Australia for the purposes of the Income Tax Assessment Act 1936: s995-1(1).
- Person includes a company: s 995-1(1).

Definition of "Resident" – Section 6(1)

Resident or resident of Australia means:

(a) a person, other than a company, who resides in Australia and includes a person:

(i) whose domicile is in Australia, unless the Commissioner is satisfied that his permanent place of abode is outside Australia;

(ii) 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; or

(iii) who is:

(A) a member of the superannuation scheme established by deed under the Superannuation Act 1990; or

(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 sub- subparagraph (A) or (B); and

(b) a company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia.

Residence of Individuals

- Section 6(1) ITAA 1936.
- 4 alternative tests (only need to satisfy one):
  1. Resides test.
  2. Domicile and permanent place of abode test.
  3. 183-day test.
  4. Commonwealth superannuation test.

NOTE: These are the tests for Australian residents, not international residents.

→ Each country has their own tests. When using these tests, you are asking if someone is an Australian resident, not if they are a resident of another country.
→ For example: When applying the 183-day test, you are not calculating how many days they have stayed in another country, but how many days in Australia.

1. The 'Resides' Test

Courts Have Developed the Following Factors:

- Physical presence: *Applegate, Pechey, Miller*.
  - Generally, physical presence is the most important factor, with 6 months a considerable time. Note exceptions in *Rogers* and *Slater*.
- Frequency, regularity and duration of visits.
- Maintenance of a place of abode.
- Family, employment or business ties: *Levene*.
- Habits and mode of life: *Lysaght*.
- Nationality.

Commissioner Considers Two Elements:

1. The person's behaviour while in Australia; and
2. Physical presence (6 months is a considerable time).

Behaviour Factors (*Taxation Ruling TR 98/17*):

- Intention and purpose of presence;
- Family and business/employment ties;
- Maintenance and location of assets; and
- Social and living arrangements.

FCT v Applegate

Facts: A solicitor was sent by his employer to Vanuatu to establish a new branch office. He left Australia accompanied by his wife. Soon after arriving in Vila they moved into a rented house under a 12-month lease with an option to renew for a further 12 months. They obtained a Vanuatu residency permit for two years. The solicitor did not own a house in Australia and gave up the lease of a flat in Sydney before leaving and he left no assets in Australia but retained his membership of a hospital fund. He and his employer always intended that he would return to Australia after a period that had not yet been determined. However, due to ill health he returned to Australia after being away for two years.

Court held: The taxpayer could not be considered to be residing in Australia, as he was not physically present.