

## Week 5 – Statutory Income – Lecture Notes

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

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

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

- 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 deduct in a later income year: see Division 36.

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

- (1) Your *assessable income* includes income according to ordinary concepts, which is called *ordinary income*.
- “Income” and “income according to ordinary concepts” is not defined in the Income Tax Assessment Acts.
  - **Must refer to case law.**

### 6-10 Other assessable income (*statutory income*)

- (1) Your *assessable income* also includes some amounts that are *not* \*ordinary income.
- (2) Amounts that are *not* \*ordinary income but are included in your assessable income by provisions about assessable income, are called *statutory income*.

### 6-15 What **is not** assessable income

- (1) If an amount is *not* \*ordinary income, and is *not* \*statutory income, it is not *assessable income* (so you do not have to pay income tax on it).
- (2) If an amount is \*exempt income, it is not *assessable income*.
- (3) If an amount is \*non-assessable non-exempt income, it is not *assessable income*.

## 1997 Act

- Balancing Adjusting Events Div 40 (week 8) (e.g., disposal of depreciating asset)
- Trading stock Div 70 (week 8)
- Capital Gains Div 102 (week 4)
- Franking Credits Div 207 (week 10)
- S15-2 (if non-convertible benefit)
- Note: also know s6-10, s6-25

## 1936 Act

- Dividend s44 (see week 10)
- Partnership income: s 92 & Beneficiaries of a trust: s 97 (see week 10)

Except for s15-2, all of these sections will be explored in more detail in other weeks of course. Today's lecture simply provides a brief overview of statutory income.

**6-25** If an amount is assessable under multiple provisions of the Act, it's included in assessable income only once.

- **General rule** – SI provisions prevail over OI
- **Exception** – If the SI provisions express a contrary intention so that s6-5 applies instead.

## 15-2 Benefits relating to employment or services rendered

**This section does not apply if amount is income under s6-5**

**(1) Section 15-2(1)** provides that the assessable income of a taxpayer includes the value to a taxpayer of all

- Allowances
- Gratuities
- Compensation
- Benefits
- bonuses, and
- premiums

provided to the taxpayer in respect of, or for, or in relation directly or indirectly to, any employment or services rendered, including any service as a member of the Defence Force (**some causal connection to employment**).

(2) This is so whether the things were \*provided in money or in any other form.  
(doesn't need to be convertible into cash, broaden definition)

(3) However, the value of the following is **not included** in your assessable income under this section [restricts definition]:

- a. a \*superannuation lump sum or an \*employment termination payment;
- b. an \*unused annual leave payment or an \*unused long service leave payment;
- c. a \*dividend or \*non-share dividend;
- d. an amount that is assessable as \*ordinary income under section 6-5 [contrary intention];
- e. \*ESS interests to which Subdivision 83A-B or 83A-C (about employee share schemes) applies.

Note: Section 23L of the *Income Tax Assessment Act 1936* provides that fringe benefits are non-assessable non-exempt income

## 15-2 Simplified

- (1) **Benefits:** allowances, gratuities, compensation, benefits, bonuses and premiums
  - (2) **Connection requirement:** provided to you in respect of, or for or in relation directly or indirectly (broad)
  - (3) **Connection to what?** any employment of or services rendered by you (broad)
  - (4) doesn't matter if convertible or capital (Not stated in section but determined in case of **AAT Case 7752**)
- \*If overplan, prioritize s6-5 over s15-2.
  - \*S6-25 statutory income over ordinary. Exception only with contrary intention.

### ***FCT v. Dixon (1952) 86 CLR 540***

**Facts: Key fact:** taxpayer not presently working for employer, nor was promised to get his again later

Prior to WW2, taxpayer worked as clerk.

During WW2, he enlisted in the army and quit his job. His former employer made regular supplementary payments to offset his salary loss while he was serving in the army.

The taxpayer did not commit to resume his post-war employment, nor did the employer assure him that he would be re-employed.

Issue: SI? OI? (note based on old section)

### ***Smith v FCT 87 ATC 4883***

**Facts:**

Bank paid employees lump sum payment if they passed exams related to banking. Purpose was to encourage staff to be more qualified. It was not core staff duty.

Employee argued s15-2 didn't apply to this lump sum payment (1) lacked periodicity (2) was gift (3) had no connection to employment duties.

Recall s15-2 "in respect of, or for or in relation directly or indirectly to any employment or services rendered". [causation requirement]

**High Court held:** Payments were income under s 15-2

The taxpayer argued that the payment was unrelated to employment, as unrelated to any work duties.

By majority, HCA held it was a consequence of employment. Only employees qualified for the payment.

## ***FCT v Holmes 95 ATC 4476***

**Facts:** The taxpayer was a crew member (marine engineer) on an oil-rig tender that participated in the successful salvage of a burning oil tanker. Under the law of admiralty, the seaman was entitled to a reward, which was later determined by arbitration. The reward is contingent on the successful rescue.

Through arbitration, the taxpayer received \$23,381. The payment was not made by the employer and was not paid under the taxpayer's employment contract.

**Key facts:** (1) provides services (2) no contract of employment (3) paid under arbitration award, for which they are not a party

**Court held:** The reward was assessable under s 26(e) (which is now s15-2). Key reasons for decisions: (1) not a gift, as the sailor had legal right under arbitration (2) doesn't matter that payment was contingent on successful rescue (3) payment related to the performance of services, does not need to relate to employer/employee relationship

### **Return to work payments: s 15-3**

- Your assessable income includes an amount you receive under an \*arrangement that an entity enters for a purpose of inducing you to resume working for, or providing services to, any entity.

#### **Tax in Real Life**

- A one-off inducement paid to car workers so that they return to work would be covered by s 15-3

### **Accrued leave payments: s 15-5**

### **Bounties and subsidies: s 15-10**

Your assessable income includes a bounty or subsidy that:

- (a) you receive in relation to carrying on a \*business; and
- (b) is not assessable as \*ordinary income under section 6-5

3 main steps: (1) bounty or subsidy (2) received in relation to carrying on a business (3) not ordinary income under s6-5, eg capital receipts.



### ***First Provincial Building Society v FCT 95 ATC 4145***

- The taxpayer got \$1.92 million from the government when a special fund (set up to protect depositors) was shut down.
  - The **Federal Court said** this payment was **not ordinary income** because it wasn't part of daily business—it was a once-off (capital).
  - But under **section 15-10**, it **was still taxable income**, because the payment had a **real connection to the taxpayer's business**—it helped the business keep operating.
- **Key idea:** Even if a payment isn't part of normal trading, it can still be taxable if it supports the business.

### **Royalties: s 15-20**

Your assessable income includes an amount that you receive as or by way of royalty within the ordinary meaning of “royalty” (disregarding the definition of *royalty* in subsection 995-1(1)) if the amount is not assessable as \*ordinary income under section 6-5.

### **Royalty Meaning:**

What is the “ordinary meaning” of royalty? Payments may be in grant of a right/privilege:

- A fee paid to a landowner by a mining lessee for the right to operate the mine.
- A fee paid to a patent holder for utilizing the patented invention.
- A payment to an author, editor, or composer for each sale of their work by the publisher, or for each performance of a play (copyright).

### **Tax in Real Life**

- A landowner is paid a monthly fee by BHP for the right to mine coal; this royalty would be ordinary income: see ss 6-5 and 15-20 (since s 6-5 takes precedence over s 15-20).

## 15-30 Insurance and indemnities for loss of assessable income: s 15-30

Your assessable income includes an amount you receive by way of **insurance or indemnity** for the loss of an amount (the **lost amount**) if:

- (a) the lost amount would have been included in your assessable income; and
- (b) the amount you receive is not assessable as \* ordinary income under section 6-5.

This section only applies to capital receipts – normally, insurance or indemnities “fill a hole” in income or profits (*Burmah Steamship*).

It therefore rarely applies, eg suppose a taxpayer owns rental property, and property damaged by fire obtains a payment due to lost rent → replaces lost income → s6-5

Eg doctor claims insurance on a professional income replacement policy → ordinary income → 6-5 (*Smith*, week 3)

- (1) Receive by way of insurance or indemnity of loss amount (2) loss would have been assessable income (3) s6-5 doesn't apply
- What happens if a doctor gets injured and claims insurance for lost wages for 6 months (paid monthly by insurance company) – compensation payment

⇒ Based on Smith case, s6-5 applies not 15-30

## Balancing adjustment events: Div 40

- Applies when *selling* “depreciating asset” (s40-30).
- When a depreciating asset is acquired for taxable purpose, it will be depreciated based on DV (diminishing value method) or PC (Prime Cost Method, Straight Line)
- Both methods are simply estimate of the decline of value that asset → true market value may differ
- If asset is sold at a value different to its book value (adjustable value), the difference will need to be declared as either *statutory income* or a *specific deduction*

Balancing adjustment event happens to a depreciating asset and its termination value is more than its adjustable value: s40-285(1)

- Definition of “depreciating asset”: s40-30
- Definition of “balancing adjustment event”: s40-295
- Definition of “termination value”: s40-300 & s40-305 [in most cases, the sale value]
- Definition of “adjustable value”: s40-85. [written down value of asset]

#### 40-30 What a *depreciating asset* is

(1) A ***depreciating asset*** is an asset that has a limited \* effective life and can reasonably be expected to decline in value over the time it is used, **except**:

- (a) land; or
- (b) an item of \* trading stock; or [other sections deal with this in the ITAA]
- (c) an intangible asset, unless it is mentioned in subsection (2).

(2) These **intangible assets** are ***depreciating assets*** if they are not \* trading stock:

- (a) \* mining, quarrying or prospecting rights;
- (b) \* mining, quarrying or prospecting information;
- (c) items of \* intellectual property [important];
- (d) \* in-house software;
- (e) \* IRUs;
- (f) \* spectrum licences;
- (g) \* datacasting transmitter licences;
- (h) \* telecommunications site access rights.

(3) This Division applies to an improvement to land, or a fixture on land, whether the improvement or fixture is removable or not, as if it were an asset separate from the land.

**Keynote: Can depreciate IP but cannot depreciate land or trading stock. Trading stock has its own specific legislation which we often examine!!**

#### 40-285 Balancing adjustments

(1) An amount is included in your assessable income (**statutory income**) if:

- (a) a \*balancing adjustment event occurs for a \*depreciating asset you \*held and:



(i) whose decline in value you worked out under Subdivision 40-B (you calculated depreciation according to legally accepted methods); or

(ii) whose decline in value you would have worked out under that Subdivision if you had used the asset; and

(b) the asset's \*termination value is more than its \*adjustable value just before the event occurred. (terminal value > adjustable value)

The amount included is the difference between those amounts, and it is included for the income year in which the balancing adjustment event occurred.

**Note:** The most common balancing adjustment event is where you sell the depreciating asset.

## 2 Key scenarios for balancing adjusting events for depreciating assets

1. If the *termination value* (sale proceeds) > than the adjustable value (written down value), you include the excess in your assessable income (statutory income)
  1. Eg termination value = \$1,100 and adjustable value = \$900, statutory income = \$200 (see s40.285(1)). Why?
2. If the termination value < than the adjustable value, you can deduct the difference.
  1. Eg termination value = \$6000 and adjustable value = \$7000, specific deduction of \$1000 can be claimed (see s40.285(2))  
Why?

## Simple Example

- Bought for 2000, immediately used for business purposes, and depreciated straight line at \$500 per year,
  - Purchase: 2000
  - Year 1 end: 1500
  - Year 2 end: 1000
  - Year 3 end: 500
  - Year 4 end: 0
- If at end of year 2, asset sold for \$1300, the taxpayer has essentially claimed too much depreciation relative to true depreciation of asset
  - $1300 - 1000 = \text{statutory income} = 300$
  - In year 1 and 2,  $500 + 500 = 1000$  deductions of claims.
- Conversely, if at end of year 2, asset sold for \$500, the taxpayer has not claimed enough
  - $1000 - 500 = \text{specific deduction}$

- The **value of an asset** dropped from **\$2,000** to **\$500**.  
→ That means the **decline in value** is **\$1,500**.
- But the **taxpayer has only claimed deductions of less than \$1,500** so far (let's say just \$1,000).
- So the taxpayer is **missing out** on **\$500** worth of deductions (\$1,500 decline – \$1,000 claimed = \$500 unclaimed).

## Franking credits: Div 207

### 207-20 General rule – gross-up and tax offset

- (1) If an entity makes a \*franked distribution to another entity, the assessable income of the receiving entity, for the income year in which the distribution is made, includes the amount of the \*franking credit on the distribution. This is in addition to any other amount included in the receiving entity's assessable income in relation to the distribution under any other provision of this Act.
- Dividends are paid out of profits which have already been subject to Australian company tax
  - These dividends are referred to as 'franked', indicating that they come with franking credit. This credit reflects the tax already paid by the company on these dividends.

Under Australia's system,

- Both the dividend and franking credit are statutory income
- **The franking credit is also a tax offset**

Remember s4-10(3): **Income tax** = (Taxable income x Rate) – Tax offsets