TOPIC 1 – Introduction To Tax Policy & The Australian Tax System

INTRODUCTION TO TAX POLICY & THE TAX SYSTEM

What is Tax?

The classic formulation is from Latham CJ in *Matthews v Chicory Marketing Board (Vic)* (1938) 60 CLR 263, 276: tax is a **"compulsory extraction of money by a public authority for public purposes, enforceable by law, and is not a payment for services rendered."**

Four elements from Latham's definition:

- Compulsory extraction of money
- By a public authority
- For public purposes
- Enforceable by law; not a payment for services

The OECD defines tax as **"compulsory unrequited payments to general government or to a supranational authority."**

A tax is distinguished from a fee, charge, or penalty.

In *Roy Morgan Research v FCT* [2011] HCA 35, the superannuation guarantee charge was held to be a tax: it was "a compulsory exaction of money by a public authority for public purposes, enforceable by law." Relevantly, a charge can still be a tax even if it regulates activity and raises minimal revenue, and even if it allows the Commonwealth to regulate in areas of State power, provided it forms part of general revenue.

Why We Have Taxes: The Triple Rs

Three core reasons (the "Triple Rs"):

1. **Raise Revenue:** Fund public goods that the market will not supply in sufficient quantity. Public goods have two critical properties: (i) it costs nothing for an additional individual to enjoy them; and (ii) they are non-excludable. National defence is the classic example. Today, health and education (~25% of federal expenditure) are treated as public goods.
2. **Redistribute:** Fund transfers to address economic inequality and poverty. About 36% of federal expenditures are on social security and welfare (age pension, family payments, disability support, unemployment benefits). These are "transfer" payments.
3. **Regulate:** Limit or encourage activities for the good of society (eg, taxes on tobacco, pollution, or road congestion, sometimes called Pigouvian taxes).

Adam Smith observed that only taxes could provide "that sure, steady, and permanent revenue which can alone give security and dignity to government." Taxes account for around 93% of federal government revenue; the federal government raises about 80% of total taxes in Australia.

Alternative Options to Raise Revenue (Other Than Tax)

- Commandeer resources from private individuals
- Government enterprise
- Create/print money
- Borrow
- User charges
- Taxation

Tax Expenditures

Normally, the government collects tax from everyone according to the standard rules. A tax expenditure is when the government deliberately gives certain taxpayers or activities a break from those standard rules, meaning it collects less tax than it otherwise would.

- **Income Tax Assessment Act 1936 (ITAA 1936):** Much remains operative and is read together with the ITAA 1997. In the event of inconsistency, the 1997 Act generally prevails, but many provisions of the 1936 Act remain in force.
- **Income Tax Act 1986 (Cth):** Imposes income tax at rates declared by the *Income Tax Rates Act 1986*.
- **Taxation Administration Act 1953 (Cth) (TAA):** Governs administration, including PAYG withholding, penalties and the objection/review process.
- **International Tax Agreements Act 1953 (Cth):** Gives effect to Australia's tax treaties. Section 4 provides the Act is to be read with the ITAAs; in the event of conflict, the Agreements Act prevails (with the exception of Pt IVA ITAA 1936).

Relationship Between ITAA 1936 and ITAA 1997

- The ITAA 1997 was created as part of the **Tax Law Improvement Project (TLIP)**: a rewrite of the 1936 Act into clearer language. As regimes were rewritten, they were transferred from the ITAA 1936 to the ITAA 1997. TLIP has stalled and been largely abandoned.
- **Same idea, different words:** If the ITAA 1936 expresses an idea in a particular form and the ITAA 1997 appears to express the same idea differently for clarity and simplicity, there is **no change in meaning** (ITAA 1997 s 1-3).
- **Existing rulings preserved:** A public or private ruling about a provision of the ITAA 1936 is taken also to be a ruling about the corresponding provision of the ITAA 1997, so far as the two provisions express the same ideas (TAA Sch 1, s 357-85). This is also consistent with *Acts Interpretation Act 1901* (Cth) s 15AC.
- Note the new numbering system in the ITAA 1997: **Division number - Section number** (eg, s 8-1).
- Also add the **GSTA** to the principal statutes list: *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

Role of the Courts: Interpretation of Tax Legislation

Historically, Australian courts (following English decisions) took the view that tax legislation was to be **strictly construed in favour of the taxpayer.** Beginning in the 1980s, courts moved to a more **purposive** approach, partly through changes to the *Acts Interpretation Act 1901* (Cth).

The current approach was summarised in *MLC Ltd v FCT* (2002) 51 ATR 283 by Hill J at 291-292:

> The task of statutory construction is not mechanical. It begins with the words used, but context is central. Citing *CIC Insurance Ltd v Bankstown Football Club Limited* (1997) 187 CLR 38, the modern approach to statutory interpretation:
>
> - "(a) insists that the context be considered in the first instance, not merely at some later stage when ambiguity might be thought to arise, and (b) uses 'context' in its widest sense to include such things as the existing state of the law and the mischief which, by legitimate means, one may discern the statute was intended to remedy."
> - "If the apparently plain words of a provision are read in the light of the mischief which the statute was designed to overcome and of the objects of the legislation, they may wear a very different appearance."
> - "Inconvenience or improbability of result may assist the court in preferring to the literal meaning an alternative construction which, by the steps identified above, is reasonably open and more closely conforms to the legislative intent."

INTRODUCING THE FRAMEWORK FOR TAXING INCOME

The Basic Calculation Formula

Taxable income = Assessable income - Deductions (ITAA 1997 s 4-15(1))
Income tax payable = (Taxable income x Rate scale) - Tax offsets (ITAA 1997 s 4-10(3))

Full calculation including other levies:

Component	
Taxable income x Tax rate scale - Tax offsets	= Income tax

s 104-155(1): CGT event H2 happens if a taxpayer receives money or property in respect of an act, transaction, or event *relating to* a CGT asset of theirs.

- **Most residual event:** H2 only applies if no other CGT event applies (even more residual than D1)
- **Application:** Used e.g. for receipts on *variation of share rights* (TR 94/30 [47]) where D1 does not apply because no entirely new intangible asset is vested in another
- **Gain calculation:** Same as D1 — capital proceeds less only incidental costs

D.8 CGT Assets: s 108-5 ITAA 1997

s 108-5(1): A *CGT asset* is:

- **(a)** any kind of *property*; or
- **(b)** a *legal or equitable right* that is not property

s 108-5(2): To avoid doubt, the following are CGT assets:

- **(a)** a part of, or an interest in, an asset referred to in subsection (1)
- **(b)** goodwill or an interest in goodwill
- **(c)** an interest in an asset of a partnership
- **(d)** an interest in a partnership

"Property" — general law meaning:

- Rights that are definable, identifiable by third parties, capable of assumption by third parties, and sufficiently permanent or stable (the "Ainsworth test")
- Courts also consider excludability, commercial value, and enforceability against third parties generally

"Legal or equitable rights" (para (b)):

- Catches rights that do not constitute property in the strict legal sense but are recognised in equity
- Avoids the argument that only assignable rights qualify (see *Orica* on alienability — not essential)

***TD 2014/26* — Bitcoin as a CGT Asset**

Bitcoin holding rights are property under s 108-5(1)(a); a person holding bitcoin holds a CGT asset.

Legal analysis:

- No single test determines whether something is "property." Courts consider: excludability, commercial value, enforceability, the Ainsworth test
- Bitcoin holding rights = the capacity to control and trade a bitcoin, restricted by the software to the holder of the private key
- Bitcoin is treated as valuable transferable property in commerce; active markets exist: supports proprietary character
- Bitcoin holding rights are definable, identifiable, capable of assumption, and stable: satisfies Ainsworth test
- **Conclusion [para 12]:** Bitcoin holding rights are property under s 108-5(1)(a); a bitcoin is a CGT asset

Wallet vs individual bitcoin [paras 13–14]:

- Wallet rights = the broader interest (the whole including the lesser)
- Rights in the private key: fall short of "property" under para (a) but give rise to an equitable right under para (b) (law of confidential information)
- A disposition of the wallet = in normal circumstances a disposition of all bitcoin in it

Note: Crypto assets are NOT treated as "foreign currency" for income tax: Treasurer Media Release (22 June 2022) and subsequent legislation.

***TR 94/30* — Nature of a Share as a CGT Asset**

A share is a *single* CGT asset comprising a bundle of rights; the individual rights attaching to the share are not separate CGT assets and cannot be dealt with independently of the share itself.

Key principles:

- Stamp duty or similar duty
- Costs of advertising to find a seller or buyer
- Borrowing costs of acquiring the asset (but not if deductible under s 8-1)
- Do NOT include amounts that are otherwise deductible: s 110-45(1B)

Third element — s 110-25(4): The costs of *owning* the CGT asset — being non-capital costs incurred *after 20 August 1991* in the period the taxpayer owned the asset (e.g., interest, insurance, maintenance, rates), BUT ONLY if:

- the amounts are *not otherwise deductible* (i.e., cannot be claimed under s 8-1); AND
- the asset was *not* used to produce assessable income during the ownership period

Practical effect: The third element principally captures costs of owning private assets (e.g., a holiday house) where no deduction is available. For income-producing assets, costs are deductible under s 8-1 and thus excluded from the cost base by s 110-45(1B).

Fourth element — s 110-25(5): Capital expenditure incurred to:

- *increase* or *preserve* the value of the asset; or
- *install* or *move* the asset

Fifth element — s 110-25(6): Capital expenditure incurred to:

- *establish*, *preserve* or *defend* the taxpayer's title to the CGT asset; or
- *establish*, *preserve* or *defend* a right over the CGT asset

E.3 Anti-Double-Counting: s 110-45 ITAA 1997

s 110-45(1B): For assets acquired after 13 May 1997 — an amount that has been *allowed as a deduction* cannot form part of the cost base (elements 2 and 3 expressly). Exception: if the deduction has been reversed by an offsetting income inclusion, the amount *can* enter the cost base.

Purpose: Prevents the taxpayer from subtracting the same cost twice — once as a deduction from income and again as part of the cost base reducing a capital gain (or inflating a capital loss).

Example: Building depreciation under Div 43 (capital works deductions). Each year's deduction reduces the cost base by the amount deducted, preventing a capital loss that merely reflects deductions already taken.

E.4 Reduced Cost Base: s 110-55 ITAA 1997

The reduced cost base (used for calculating capital *losses*) includes the same five elements as the cost base EXCEPT:

- **Excludes the third element** (non-capital costs of ownership)
- **Reduced by** amounts included in assessable income by virtue of a balancing adjustment event (e.g., depreciation recapture under Div 40) and certain other amounts: s 110-55(3)
- **Not indexed** for inflation: s 110-55(1)

Practical effect: The reduced cost base is generally smaller than the cost base, which limits the size of any capital loss a taxpayer can claim.

E.5 Market Value Substitution: s 112-20 ITAA 1997

s 112-20(1): The *first element* of the cost base (and reduced cost base) is replaced by the *market value* of the CGT asset at the time of acquisition if:

- **(a)** some or all of the consideration for acquisition *cannot be valued*; or
- **(b)** the taxpayer did not deal at *arm's length* with the other party and the consideration was more or less than market value; or
- **(c)** the taxpayer did not give *any consideration* for the acquisition (e.g., received as a gift)

Practical operation: If you receive a gift of a CGT asset, or acquire at a non-arm's length price, your first element of cost base = market value at the time you acquired it.

- In substance she earned the money by: (a) devoting her time to interviews; (b) disclosing facts; and (c) lending her name to the story — all services
- The fact that she had secret/valuable information made her services more *valuable*, but remuneration for services does not become capital merely because the person is engaged for their knowledge

PRINCIPLES:

- **Knowledge is not property:** Payment for communicating information = income from services, not a capital receipt from selling a proprietary asset
- **Substance over form:** Courts characterise payments by examining what the taxpayer actually did and what the payment was actually for
- **Post-CGT note:** Had Brent contracted after 19 September 1985, and had she succeeded in characterising the payment as for a proprietary asset, CGT analysis would follow. But since knowledge is not a CGT asset (following Latham CJ in *United Aircraft*), there would still be no capital gain from "sale of information"

K.3 Payments for Varying Service Contracts

***Scott v Commissioner of Taxation (NSW)* (1935) 35 SR (NSW) 215**

Compensation for being prevented from completing a fixed-term appointment is NOT income under ordinary concepts — it replaces the loss of the *office itself* (a capital item), not the loss of periodic wages.

FACTS: The taxpayer had been appointed chairman of a board for 10 years at £2,500 per annum. The board was dissolved by statute and his position was abolished. He recovered £7,000 compensation, calculated on a wrongful dismissal basis.

ISSUE: Was the £7,000 assessable income under ordinary concepts, as a retiring allowance, or under the equivalent of s 15-2?

HELD (Jordan CJ): Not income under any ground.

REASONING (Jordan CJ):

"A price received as a consideration for going out of business or compensation received for being prevented from carrying on business any further, or for being prevented from continuing in employment, is not income, according to the natural meaning of the word."

- The mere fact that compensation was *measured* by reference to future wages is not conclusive
- The payment replaced the *office* (a capital asset), not the periodic income stream under the office

***Commissioner of Taxes (Vic) v Phillips* (1936) 55 CLR 144**

Where a taxpayer exchanges a right to future periodic income for another right to payments of the *same periodicity, duration and estimated amount*, the substitute payments are income.

FACTS: The taxpayer had an agreement to serve as managing director for 10 years, receiving a director's fee plus 12.5% of net annual profits, payable monthly. When Central sold its theatre business, the purchaser did not want Phillips as managing director. Central cancelled Phillips' contract and agreed to pay £20,301 by monthly instalments of £404 over the remaining contractual term, calculated to equal the estimated future monthly payments he would have received.

ISSUE: Were the instalment payments assessable as income?

HELD (Dixon and Evatt JJ): Yes.

REASONING:

- The taxpayer gave up one right to receive monthly income in exchange for another right to monthly payments of the *same periodicity*, *same duration*, and *same estimated amount*: he "exchanged a right to receive, through the same duration of time and at the same intervals of time, amounts estimated as equivalent to the income otherwise payable to him"
- An income stream cannot be converted to capital merely by paying its present value in advance: the character of the new payments mirrors the old
- The total being expressed as a lump sum in the contract is merely arithmetic: "the statement is no more than an arithmetical equivalent"

PRINCIPLE (the Phillips rule): Where one income stream is exchanged for another of the same periodicity, duration, and estimated amount, the substitute stream is income. This is the service contract application of the compensation principle (see also Ch 6 compensation receipts).

- Key distinction: temporary impairment of earnings (filling a revenue hole) = income; permanent impairment of earning capacity (capital asset destroyed) = capital
- The court looks at the substance of what was damaged, not merely how the taxpayer characterises its claim
- Distinguish from *Sydney Refractive*: there, the injury permanently impaired earning capacity; in *Liftronic*, the business recovered and the damages merely restored lost profits during the period of impairment

***FCT v CSR Ltd* (2000) 45 ATR 559**

Where a settlement amount includes both income and capital components with no basis for apportionment, none of the amount is ordinary income (McLaurin/Allsop principle); and the fact that a payer is an insurer does not automatically mean the payment is "by way of insurance."

FACTS: CSR settled claims against its insurer NZI (arising from asbestos liabilities) for $100m. The settlement released multiple causes of action, including claims for indemnity under policies, damages for breach of contract and bad faith, damage to goodwill and credit rating, and wrongful interference with business.

HELD: The $100m was not ordinary income. The ATO's fallback argument under s 26(j) (now s 20-20(2)) also failed.

REASONING:

- Because some causes of action released (damage to goodwill, credit rating, wrongful interference with business) would have generated non-income receipts, and no apportionment between income and non-income causes of action was possible on the face of the deed, none of the $100m was ordinary income: "*Allsop* governs the issue."
- On s 26(j)/s 20-20(2): "one amount received by the insured from the insurer may fall within the paragraph while another may not. The fact that a taxpayer receives a payment from an entity that is its insurer does not necessarily signify that the payment is received by way of insurance... It is not permissible to substitute, for characterisation of the particular amount received, a characterisation of the general relationship between the parties."

PRINCIPLES:

- McLaurin/Allsop principle: where a receipt contains both income and capital components and no attribution is possible, none of the receipt is ordinary income
- Practical lesson: where a settlement must include capital claims (goodwill, reputation), ensure those claims are expressly included in the deed; this can prevent the whole amount from being characterised as income
- "By way of insurance": the insurer/insured relationship is not sufficient; the particular payment must itself be characterised
- CSR conceded the amount gave rise to a capital gain, making it important to treat as CGT rather than income (CGT discount available; income tax rate not)

PART 4: COMPENSATION FOR SPECIFIC ASSET TYPES

4.1 Trading Stock

- s 70-115 ITAA 1997: specifically includes in assessable income an amount received as insurance or indemnity for trading stock
- This provision is possibly unnecessary: *FCT v Wade* (1951) 84 CLR 105 held that compensation for destruction of a diseased herd was assessable under ordinary concepts (s 6-5) anyway
- Special concession for primary producers (s 385-100 ITAA 1997): where an entire herd is involuntarily and unexpectedly destroyed, the taxpayer may elect to either spread the unexpected gain over five years or apply the gain in reduction of the cost of any replacement trading stock purchased

4.2 Revenue Assets

- Where the asset is a revenue asset of the business, compensation for its loss may be income
- Key concept: "sterilisation" of a revenue asset (from *Glenboig Union Fireclay Co v IRC* (1922) 12 TC 427 and *Heavy Minerals v FCT* (1966) 115 CLR 512): how significant was the asset to the business and how significant was the damage?

- Gratitude for services rendered, alone, is not enough to make the receipt income
- An unsolicited gift does not become income merely because generosity was inspired by goodwill traceable to gratitude for services: *Scott v FCT*

s 6-5 ITAA 1997 – Income According to Ordinary Concepts (Ordinary Income)

s 6-5(1): Your assessable income includes income according to ordinary concepts, which is called **ordinary income**.

- Plain English: the fundamental charging provision; ordinary income is the judicial/common law concept of income.
- Note: some provisions listed at s 10-5 may affect the treatment of ordinary income.

s 6-5(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.

- Plain English: residents taxed on worldwide ordinary income.

s 6-5(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.
- Plain English: foreign residents taxed only on Australian-source ordinary income (plus any other basis prescribed by a provision).

s 6-5(4): In working out whether you have derived an amount of ordinary income, and 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**.

- Plain English: constructive receipt rule. You derive income when it is paid to a third party at your direction – not only when you personally receive cash. This is the statutory basis for the doctrine that salary directed to a third party remains your ordinary income.

3. Statutory Income from Services: s 15-2 ITAA 1997 (former s 26(e) ITAA 1936)

s 15-2 ITAA 1997 – Allowances and Other Things Provided in Respect of Employment or Services

s 15-2(1): Your assessable income includes the value to you of all **allowances, gratuities, compensation, benefits, bonuses and premiums** provided to you **in respect of, or for or in relation directly or indirectly to**, any employment of or services rendered by you (including any service as a member of the Defence Force).

- Plain English: a wide catch-all for non-cash and non-salary remuneration. Uses "value to you" (not "convertible to money"), which is a broader valuation basis than ordinary income.

s 15-2(2): This is so whether the things were provided **in money or in any other form**.

- Plain English: applies to both cash and non-cash benefits, removing any argument that only cash receipts are covered.

s 15-2(3): However, the value of the following are **not** included in your assessable income under this section:

- **(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 s 6-5.
- **(e)** ESS interests to which Subdivision 83A-B or 83A-C (employee share schemes) applies.
- Plain English for (d): s 15-2 is a **fallback provision** – it does not operate where the amount is already ordinary income under s 6-5. This is the source of the priority rule discussed at Part A, Section 4.

Note: s 23L ITAA 1936 provides that fringe benefits are non-assessable non-exempt income of the employee (below).

Key features:

- The connection test is the same wording as in former s 26(e) ITAA 1936; the cases on s 26(e) apply directly to s 15-2
- The section uses "in respect of, or for or in relation directly or indirectly to" employment – very wide language

568). Dixon CJ and Williams J concluded that because the £104 "was an expected periodical payment arising out of circumstances which attended the war service" and "formed part of the receipts upon which he depended for the regular expenditure upon himself and his dependants", it had "the character of income" within s 25 (557).

PRINCIPLES

- **Foundational nexus test for s 26(e) / s 15-2:** A benefit must be a recompense or consequence of the continued or contemporaneous existence of the employment relationship, or a reward for services rendered. A mere "but for" or historical connection to employment is insufficient.
- **Employment as a selection criterion is not enough:** The fact that only employees of the firm received the payment does not make it a payment in respect of employment if the dominant reason for the payment is extraneous to the employment (here, recognition of enlistment and public sacrifice).
- **Character of receipt determines taxability:** Webb J emphasised that the quality of a payment is not determined by the yardstick used to quantify it; the measure of the gap between military and civilian pay did not transform a reward for enlistment into remuneration for employment (563).
- **Substitute income rule:** Where a voluntary payment is intended to replace or maintain income that would otherwise have been earned, it may be assessable as ordinary income under s 25 even if outside s 26(e). The payment acquires the income character of that which it substitutes.
- **Exam flag:** *Dixon* is the starting point for all s 26(e) / s 15-2 nexus analysis. Its formulation that the benefit must be "a recompense or consequence of the continued or contemporaneous existence of the relation of employer and employee" is cited in every subsequent case in this area, including *Hayes*, *Scott*, *Smith*, *Payne* and *Holmes*. The distinction between the s 25 holding (assessable) and the s 26(e) holding (not assessable) is itself examinable.

***FCT v Harris* (1980) 30 ALR 10**

An ex gratia lump sum payment by a former employer to a retired pensioner to compensate for the effects of inflation was not assessable income because it was not the product of the taxpayer's employment in any relevant sense, and the first payment could not be characterised as the first of a series of periodic income receipts.

FACTS: Harris retired from the ANZ Banking Group in November 1974 and became entitled to a pension under the bank's staff pension scheme, commuting part of it for a capital sum. In April 1976, some 18 months after retirement, the bank sent all pensioners a memorandum describing an "ex gratia cash payment" to assist with the problems caused by continuing high inflation, accompanied by a cheque for $450. The payment was entirely unexpected and unsolicited. It was not related in any way to the length or quality of Harris's service or his seniority at retirement. Harris was employed elsewhere after retirement and did not need the payment for living expenses. He received further similar payments in the three succeeding years ($625, $558, and a comparable amount). The Commissioner assessed the $450 as income for the year ended 30 June 1976.

ISSUE: Whether the $450 ex gratia payment was assessable income in Harris's hands under s 25(1) ITAA 1936 as income according to ordinary concepts.

HELD: Majority (Bowen CJ and Fisher J): appeal dismissed. The payment was not assessable income. Deane J dissented, holding it was income according to ordinary concepts.

REASONING

The product of employment test

All judges accepted that whether a receipt is income depends on its quality in the hands of the recipient, assessed by reference to the whole of the circumstances. The generally decisive question is whether the receipt is "the product in a real sense of any employment of, or services rendered by the recipient" (14, citing *Hayes*, *Scott*, *Squatting Investment*). The prior employment was relevant in the sense that it explained why Harris received the payment at all, but the amount bore no relation to length or quality of service. As Fisher J put it, the prior employment "explains why the bank was motivated to make a payment to him" but "is of no great assistance in categorizing the payment" (25). The payment was not the product of employment in any relevant sense.

Distinguishing Dixon

Bowen CJ and Fisher J distinguished *FCT v Dixon* (1952) 86 CLR 540 on two grounds. First, in *Dixon* the payments were regular and periodic additions to the taxpayer's military pay, made pursuant to an undertaking by the employer to make up the difference between civilian and service pay; Harris's payment was a single unsolicited lump sum with no such undertaking. Second, the *Dixon* majority found the payments incidental to current employment as a soldier; Harris was not in any employment to which the payment could be said to be incidental

- **MT 2019, para 6**: Where a benefit is provided to a shareholder-employee by reason of both their employment and shareholding, it is taken to be provided in respect of employment. But if provided solely by reason of their position as a shareholder and not to any extent by reason of employment, it is not FBT.

The required nexus after *J & G Knowles v FCT* (2000) 44 ATR 22: The Full Federal Court held the phrase requires "a nexus, some discernible and rational link, between the benefit and employment." However, not any causal connection suffices; it must be "a sufficient link for the purposes of the particular legislation." A rent-free family home arranged via a discretionary trust controlled by directors was not provided "in respect of" employment; the reason was the trust structure, "extraneous to the employment."

Element 6: Not Specifically Excluded

Section 136(1) lists a number of exclusions from the definition of "fringe benefit." The most important are:

- **Para (f): Salary or wages** – cash salary is never a fringe benefit; it is assessed under s 6-5. This creates the fundamental demarcation between FBT and income tax. Key distinction: allowances are salary or wages (assessable income to employee); reimbursements of employment expenses may be expense payment fringe benefits. (*Roads and Traffic Authority of NSW v FCT* (1993) 43 FCR 223 held that travel allowances payable under an award with no requirement to account for the money were salary or wages, not expense payment fringe benefits.)

s 136(1) FBTAA

"salary or wages" means:
- **(a)** a payment from which an amount must be withheld (even if the amount is not withheld) under a provision in Schedule 1 to the TAA 1953 listed in the table, to the extent that the payment is assessable income; and
- **(aa)** a payment from which an amount must be withheld under para 12-110(1)(ca) (about parental leave pay), other than a payment under Part 3-3 of the Paid Parental Leave Act 2010; and
- **(b)** a payment made to a religious practitioner by a religious institution from which an amount must be withheld.

The table covers: payments to employees (s 12-35), to company directors (s 12-40), to office holders (s 12-45), Commonwealth education or training payments (s 12-115), and compensation, sickness or accident payments (s 12-120).
- Plain English: "salary or wages" for FBT purposes is defined by reference to PAYG withholding obligations, not by reference to common law employment concepts. Crucially, it is the para (f) exclusion from the fringe benefit definition: salary or wages are assessed under income tax (s 6-5), not FBT. The line between a salary allowance (assessed to the employee) and an expense payment fringe benefit (FBT on employer) depends on whether the payment is salary or wages.

- **Para (j): Superannuation contributions** – employer contributions to a complying superannuation fund are not fringe benefits (they are deductible employer expenditure)
- **Para (m): Capital payments for restrictive covenants and personal injury settlements** – dealt with elsewhere in the ITAA
- **Para (ha): Employee share schemes** – shares and options under Div 83A ESS are excluded from FBT
- **Eligible termination payments** – dealt with under Divs 80–83 ITAA 1997

Exempt benefits are also not "fringe benefits" for FBT purposes. Examples:
- s 41 FBTAA: property provided and consumed on business premises on a working day (eg food in staff canteen)
- s 47(2): residual benefit being provision of in-house child care on employer's business premises
- Div 13 miscellaneous exempt benefits: job interview expenses (s 58A), relocation expenses (ss 58B-58F), newspapers (s 58H), after-hours taxi travel (s 58Z)
- s 58P: **minor benefits** where the notional taxable value of benefits provided in the year is under $300
- s 58X: **eligible work-related items** (laptops, mobile phones, tools used predominantly for work)
- s 62: $1,000 general threshold for in-house benefits

Formula: [C × (100% - BP)] - R

Where:

- **C** = operating cost of the car during the holding period;
- **BP** =
  - **nil** if under s 10A or 10B the employer is not entitled to a reduction on account of business journeys; or
  - in any other case, the **business use percentage** applicable to the car for the holding period; and
- **R** = the **recipient's payment** (as defined in s 10(3)(c), same structure as s 9(2)(e)).

s 10(3)(a) – Operating cost during the holding period is the sum of:

- **(i)** any car expenses (other than insured repair expenses or registration/insurance) incurred during the holding period (whether by provider or any other person);
- **(ii)** registration and insurance expenses attributable to the holding period;
- **(iii)** where the car is **owned** by the provider:
  - **(A)** the amount of **depreciation** deemed to have been incurred in respect of the car in respect of the holding period; and
  - **(B)** the amount of **interest** deemed to have been incurred in respect of the car in respect of the holding period;
- **(iv)** where owned and a non-business accessory was fitted: deemed depreciation and interest on that accessory;
- **(v)** where the car is **leased**: so much of the lease charges attributable to the holding period; and
- **(vi)** where neither owned nor leased: the depreciation and interest that would have been incurred had the car been purchased for its leased car value at the commencement of holding.

s 10(4): The election must be made by notice in writing to the Commissioner, lodged on or before the declaration date.

s 10(5): If the cost basis method produces a higher taxable value than the statutory formula, the Act applies as if the election had not been made (the statutory formula result applies instead).

- Plain English: the cost basis method favours employers whose employees use company cars predominantly for work (high business use percentage). The employer must keep log books to substantiate the business use percentage (s 10A). If the employee uses the car mainly for private purposes, the operating cost method may produce a higher taxable value than the statutory formula – in which case the Act reverts to the statutory formula. The cost basis method is therefore only advantageous where the business use percentage is high.

Loan fringe benefits (Div 4):

A loan benefit arises where an employer lends money at a reduced interest rate (s 16). Taxable value under s 18 is the difference between interest actually charged and the benchmark interest rate (Reserve Bank large bank variable housing rate). The "otherwise deductible" rule in s 19 can reduce the taxable value where the loan is used to produce assessable income.

s 18 FBTAA – Taxable Value of Loan Fringe Benefits

s 18(1): Subject to this Part, the taxable value, in relation to a year of tax, of a **loan fringe benefit** provided in respect of the year of tax is the amount (if any) by which:

- the **notional amount of interest** in relation to the loan in respect of the year of tax; **exceeds**
- the **amount of interest** that has accrued on the loan in respect of the year of tax.
- Plain English: the taxable value is the interest subsidy – the difference between what the employee actually paid (or was charged) and what they would have been charged at the statutory benchmark interest rate (the Reserve Bank's large bank variable housing loan rate). If the loan carries no interest, the taxable value is the full notional interest at the benchmark rate.

Property fringe benefits (Div 11):

A property benefit arises when an employer transfers property to an employee (giving ownership, not mere use). Taxable value depends on whether it is an "in-house" benefit (trading stock the employer normally sells to outsiders):

Suggests a business IS being carried on	Suggests a business is NOT being carried on
Repetition and regularity	Little repetition or regularity
Carried on in a similar manner to the ordinary trade	Carried on in an ad hoc manner
Organised and carried on in a businesslike manner; records kept	Not organised or carried on systematically; records not kept
Significant size and scale	Small size and scale
Not a hobby, recreation, or sporting activity	Is a hobby, recreation, or sporting activity
Business plan exists	No business plan
Commercial sales of product	Sales to relatives and friends only
Taxpayer has relevant knowledge or skill	Taxpayer lacks knowledge or skill

TR 97/11, paras 15-17:

- No single indicator is decisive; there is often significant overlap
- The indicators must be considered in combination as a whole
- Where an overall profit motive appears absent and the activity does not look like it will ever produce a profit, it is unlikely to amount to a business
- The weighting given to each indicator may vary from case to case

Business vs Hobby or Pastime

A taxpayer pursuing a hobby or pastime, however vigorously or systematically, does not thereby carry on a business, and gains from the pursuit are not ordinary income. The distinction is critical because:

- Receipts from activities that are a hobby will not be ordinary income
- Expenses incurred in a hobby will not be allowable deductions

The two common hobby-or-business contexts: gambling and elite sport.

Gambling

Professional bookmakers and casino operators carry on a gambling business (by virtue of their scale, commerciality, and profit intention). Individual punters are very unlikely to be in business, even with systematic methods, because the element of chance in gambling almost invariably militates against a business finding.

The ATO's difficulty with gambling cases: The ATO pursued gamblers in a series of cases in the late 1980s and lost each one. The reason the ATO pursued gamblers was usually that a tax audit disclosed unexplained wealth which the taxpayer attributed to gambling winnings – the auditor did not believe the taxpayer but could not prove otherwise, so attempted to render the matter moot by asserting that even gambling winnings were taxable in the circumstances. The ATO ultimately issued **Taxation Ruling IT 2655** directing auditors to stop: "The Commissioner ... considers that it will be rare for a taxpayer with no connection with racing other than betting to be carrying on a business of betting or gambling."

The two-edged sword policy point: Classifying gambling as a business wins one case for the revenue but opens the door for the millions of losing punters to claim deductions. In the long run, gamblers lose.

s 118-37 ITAA 1997 – Gambling, Games and Competitions (CGT Exclusion)

s 118-37(1)(c): A capital gain or capital loss you make from a CGT event relating directly to **gambling, a game or a competition with prizes** is **disregarded**.

Step-out:

- This provision excludes gambling gains and losses from the CGT regime entirely. It is not a provision that makes gambling winnings assessable; it simply ensures that gambling does not accidentally generate a capital gain or loss under the CGT provisions.

(Commissioner had received the Reservation Agreement before issuing the original assessment). Commissioner's appeal for 1986 dismissed.

REASONING

Characterisation of the payment (at 116):

- The Court rejected Holdings' submission that the payments were made for a "restriction, fetter or tie" on the use of Isa's generating plant. Holdings characterised the arrangement as analogous to *Dickenson*: a payment for the imposition of a restriction on the use of a significant capital asset. The Commissioner characterised it as payment for Holdings' promise to ensure its subsidiary would make generating capacity available on demand.
- The Court accepted the Commissioner's characterisation: "The clear contractual arrangement between the Government of Queensland and Holdings was that there was to be constructed by Isa a generating plant having a capacity greater than the needs of Isa and that Holdings would ensure that up to the 27 megawatts of power ... would be made available for reticulation by the Government as and when required" (at 116). Any restriction on Isa's own use of capacity was merely "incidental to the arrangement and a consequence of it. It is not what the payment received by Holdings was for" (at 117).

The eight principles stated (at 116-117):

1. Character of a receipt is assessed in the hands of the recipient: *Scott v FCT* (1966) 117 CLR 514 at 526; *Hayes v FCT* (1956) 96 CLR 47 at 55; *Federal Coke*
2. Corporate separateness must be respected; the court cannot decide tax liability on the basis of the "substantial economical business character of what was done": *Federal Coke* per Bowen CJ
3. Where the recipient provides consideration, that consideration "will ordinarily supply the touchstone for ascertaining whether that payment was received on revenue account or not": *Federal Coke* per Brennan J. Here the consideration was Holdings' undertaking to procure Isa's supply of electricity
4. The character of the receipt is not determined by the character of the expenditure the recipient is required to make: *GP International Pipecoaters*
5. A lump sum payment is not automatically capital – periodicity, regularity, and recurrence may stamp a receipt as income but their absence does not make it capital: *GP International Pipecoaters*; *FCT v Cooling*
6. The test is objective, not subjective: *Hayes* at CLR 55
7. Amounts paid in consideration of the performance of services will **almost always** be income: *Hayes* at CLR 57-58. If the agreement is properly characterised as one whereby Holdings is to procure its subsidiary to make capacity available, it will most likely be income
8. A payment made to fetter a person's capacity to perform services or carry on business **may** be capital: *Higgs v Olivier*; *Dickenson*. If the agreement is properly characterised as a restriction or fetter, that might support a capital conclusion

Distinguishing *Dickenson* (at 117):

- In *Dickenson*, the payments were for covenants negative in form and substance – the taxpayer gave up the right to sell rival brands and to open competing stations. The payment was "part of an inducement to change a feature" of the business (Dixon CJ), and Kitto J described it as "a substantial piece out of the ordinary scope of the business activities." In *MIM Holdings*, any restriction on Isa's own use of generating capacity was merely a practical consequence of its commitment to make capacity available – it was not the substance of the arrangement. The case "bears, with respect, little resemblance at all to the facts in Dickenson" (at 117).

Full and true disclosure (at 118-119):

- Without the Reservation Agreement, no one could determine whether the payments were income or capital. The description in Holdings' returns was a characterisation, not an adequate statement of the relevant facts. For 1984 and 1985, the Commissioner had never seen the Agreement before the original assessments – no full and true disclosure. For 1986, the Commissioner received the Agreement before issuing the original assessment – full and true disclosure was satisfied, and the six-year extended amendment period was not available.

PRINCIPLES

- The decisive question is always: **what is the payment actually for?** Substance governs over labels and form, and incidental consequences of the arrangement do not determine its character (at 116)
- Where the recipient provides consideration, that consideration is "the touchstone" for determining revenue or capital account (at 116, principle 3)

- **"Assessable income" is broadly construed:** The reference to "assessable income" in s 51(1) is not confined to income from a single source or activity; it encompasses all assessable income the taxpayer derives or would be expected to derive. [8] This did not, however, assist the taxpayer on the facts.
- **Exam application cue:** If a taxpayer travels between home and work = *Lunney*, not deductible. If a taxpayer travels between two unrelated workplaces = *Payne*, also not deductible. The question of whether travel between two related income-producing activities may be deductible was left open but strongly signalled to depend on whether the travel has the essential character of a working expense and whether the home-as-workplace claim is genuine.
- **Legislative response:** ITAA 1997 s 25-100 now provides a specific deduction for travel between two places of work where the taxpayer does not live at either place, responding to this area of uncertainty.

Legislation: s 25-100 ITAA 1997 – Travel Between Workplaces

s 25-100(1) – When a deduction is allowed:
If you are an individual, you can deduct a transport expense to the extent that it is incurred in your travel between workplaces.

s 25-100(2) – Travel between workplaces:
Your travel between workplaces is travel directly between 2 places, to the extent that:
- (a) while you were at the first place, you were:
  - (i) engaged in activities to gain or produce your assessable income; or
  - (ii) engaged in activities in the course of carrying on a business for the purpose of gaining or producing your assessable income; and
- (b) the purpose of your travel to the second place was to:
  - (i) engage in activities to gain or produce your assessable income; or
  - (ii) engage in activities in the course of carrying on a business for the purpose of gaining or producing your assessable income;
- and you engaged in those activities while you were at the second place.

s 25-100(3) – Exclusion (place of residence):
Travel between 2 places is **not** travel between workplaces if one of the places you are travelling between is a place at which you reside.

s 25-100(4) – Exclusion (ceased arrangement or business):
Travel between 2 places is **not** travel between workplaces if, at the time of your travel to the second place:
- (a) the arrangement under which you gained or produced assessable income at the first place has ceased; or
- (b) the business in respect of which you engaged in activities at the first place has ceased.

s 25-100(5) – No deduction for capital expenditure:
You cannot deduct expenditure under subsection (1) to the extent that the expenditure is capital, or of a capital nature.

Legislation: s 26-30 ITAA 1997 – Relative's Travel Expenses (Full Step-Out)

s 26-30(1) – Denial:
You cannot deduct a loss or outgoing you incur, insofar as it is attributable to your relative's travel, if:
(a) you travelled in the course of performing your duties as an employee, or in the course of carrying on a business for the purpose of gaining or producing your assessable income; and
(b) your relative accompanied you while you travelled.

s 26-30(2) – Exception:
Subsection (1) does not stop you deducting a loss or outgoing if:
(a) your relative, while accompanying you, performed substantial duties as your employer's employee, or as your employee; and

(b) it is reasonable to conclude that your relative would still have accompanied you even if he or she had not had a personal relationship with you.

s 26-30(3) – Fringe benefit exception:
Subsection (1) does not stop you deducting expenditure you incur in providing a fringe benefit.
(Subsections (4)–(6) extend the section to individuals who are not employees and to entities that are not employers, in connection with withholding payments.)

Post-Lunney doctrinal developments:

- **Bulky tools doctrine:** Derived from *FCT v Vogt* (1975) 75 ATC 4073. Workers transporting bulky equipment (eg, large musical instruments) were sometimes allowed deductions on the basis that the transport was necessitated by the tools, not merely the choice of residence. No deduction for small instruments.
- **Itinerant workers:** Workers required to attend multiple and shifting places of work may deduct travel from home, since home is effectively their base of operations rather than a fixed office.
- **s 25-100 (enacted in response to Payne):** Preserves deductibility for genuine inter-workplace travel. Does not apply where one of the places is the taxpayer's place of residence (s 25-100(3)), so the Lunney rule for home-to-work travel is unaffected.

Self-Education Expenses

Core distinction:

- Self-education expenses that **maintain or improve competence in the current role** and have a direct, identified income consequence are deductible: *FCT v Finn* (1961).
- Self-education expenses that merely **improve the taxpayer's general capacity** and might eventually lead to promotion or a different position are not deductible: *FCT v Hatchett* (1971) (university arts fees).
- Test: is there a **direct, perceived connection** between the expenditure and the assessable income?

Legislation: ITAA 1936 s 82A

- Previously prevented a deduction for the first $250 of "expenses of self-education" otherwise deductible under s 8-1.
- **From income years ending on or after 30 June 2023:** the threshold limitation has been removed by the *Treasury Laws Amendment (2022 Measures No 2) Act 2022* (Cth). Self-education expenses are now fully deductible if they satisfy s 8-1, with no minimum threshold.
- Background: the $250 threshold was intended to prevent a double benefit when s 159T ITAA 1936 provided a tax offset for the first $250 of education expenses. That offset was repealed in 1985 but s 82A was never updated until 2022.

ATO Position: TR 2024/3
Self-education expenses are incurred in gaining or producing assessable income if either or both of the following apply:

- **Principle 1:** Your income-earning activities are based on the exercise of a skill or some specific knowledge and the self-education enables you to maintain or improve that skill or knowledge.
- **Principle 2:** The self-education objectively leads to, or is likely to lead to, an increase in your income from your current income-earning activities in the future.

Self-education expenses are **not** deductible if either of the following apply:

- The self-education will enable you to get employment, obtain new employment, or open up a new income-earning activity (whether in business or in your current employment). This includes studies relating to a profession, occupation or field of employment in which you are not yet engaged. These expenses are incurred at a point too soon to be regarded as incurred in gaining or producing assessable income.
- You are not undertaking income-earning activities to derive assessable income at the time the expenses are incurred; the expenses are not connected to any income-earning activity at that time.

***Commissioner of Taxation v Finn* (1961) 106 CLR 60**

(a) in relation to your business; or
(b) in relation to a business that used to be carried on; or
(c) in relation to a business proposed to be carried on; or
(d) to liquidate or deregister a company of which you were a member, to wind up a partnership of which you were a partner or to wind up a trust of which you were a beneficiary, that carried on a business.

s 40-880(2A): Immediate Deduction Exception
However, you can deduct the capital expenditure **in the income year in which you incur it** if:
(a) the expenditure is incurred in relation to a **business that is proposed to be carried on**; and
(b) the expenditure is incurred:
  i. in obtaining advice or services relating to the proposed structure, or proposed operation of the business; or
  ii. in payment to an Australian government agency of fees, taxes or charges relating to establishing the business or its operating structure; and
(c) you are a **small business entity**, or an entity covered by subsection (2B), for the income year, or both of the following apply:
  i. you are not carrying on a business in the income year; and
  ii. you are not connected with, or an affiliate of, another entity that carries on a business in the income year and that is neither a small business entity, nor an entity covered by subsection (2B), for the income year.

s 40-880(2B): Entity Covered (Expanded Small Business Threshold)
An entity is covered by this subsection for an income year if:
(a) the entity is not a small business entity for the income year; an
(b) the entity would be a small business entity for the income year if:
  i. each reference in Subdivision 328-C (about what is a small business entity) to $10 million were instead a reference to $50 million; and
  ii. the reference in paragraph 328-110(5)(b) to a small business entity were instead a reference to an entity covered by this subsection.

s 40-880(3): Limitation (Taxable Purpose)
You can only deduct the expenditure, for a business that you carry on, used to carry on or propose to carry on, **to the extent that** the business is carried on, was carried on or is proposed to be carried on for a **taxable purpose**.

s 40-880(4): Further Limitation (Another Entity's Business)
You can only deduct the expenditure, for a business that **another entity** used to carry on or proposes to carry on, to the extent that:
(a) the business was carried on or is proposed to be carried on for a taxable purpose; and
(b) the expenditure is in connection with:
  i. your deriving assessable income from the business; and
  ii. the business that was carried on or is proposed to be carried on.

s 40-880(5): Exclusions – Cannot Deduct to the Extent That:
(a) it forms part of the cost of a **depreciating asset** that you hold, used to hold or will hold; or
(b) you can deduct an amount for it **under another provision** of this Act; or
(c) it forms part of the **cost of land**; or
(d) it is in relation to a **lease or other legal or equitable right**; or
(e) it would, apart from this section, be taken into account in working out:
  i. a **profit** that is included in your assessable income (eg, under s 6-5 or s 15-15); or
  ii. a **loss** that you can deduct (eg, under s 8-1 or s 25-40); or
(f) it could, apart from this section, be taken into account in working out the amount of a **capital gain or capital loss** from a CGT event; or
(g) a provision of this Act other than this section would expressly make the expenditure **non-deductible** if it were not of a capital nature; or

- **s 70-40(2)**: if not taken into account at the end of the previous year, opening value is **nil**.
- Closing stock rolls forward and effectively becomes a deduction at the start of the new year via the s 70-35 comparison.

The intuition

The scheme replicates what would happen if all stock unsold at year end were notionally sold at cost on the last day and repurchased at the same price on the first day of the new year.

Worked illustration

Tax accounts net opening and closing stock under s 70-35:

Item	**Amount**
Sales	$125,000
Excess of closing stock over opening stock ($25,000 – $22,000)	$3,000
Gross	$128,000
Less Purchases	($68,000)
Taxable income	**$60,000**

2. Derivation of sale proceeds (s 6-5)

Proceeds from sales of trading stock are **ordinary income under s 6-5**, derived when **earned/recoverable**, not when received.

J Rowe & Son Pty Ltd v FCT (1971) 124 CLR 421 (HC, Menzies J)

- Furniture/electrical retailer sold on credit (prices payable over 3+ years). Claimed deduction for cost of goods sold but returned only cash actually received or payable in the year.
- ATO assessed the full purchase price in the year of sale.
- **Held**: income of a trading business is derived when **earned**; receipt is not necessary. The "receipts only" method would produce the "odd result that as turnover increases by the sale of more and more trading stock, income falls". The existence of the bad debt write-off provision (s 25-35) confirms the accrual basis for such businesses.
- **Takeaway**: proceeds are derived when the customer's obligation crystallises, not on receipt.

3. "Incurred" and "on hand": the timing fit

If the three components of the system do not mesh, distortions arise:

Case	**Issue**	**Outcome**
FCT v Raymor (1990) 24 FCR 90	Paid for stock not delivered until next year	Deduction allowed even though no year-end re-inclusion (stock not on hand). Gap in the system.
All States Frozen Food Pty Ltd v FCT (1990) 20 ATR 1874	Stock purchased while at sea	Goods were **"on hand"** because taxpayer accepted bills of lading and became owner, despite no possession.
FCT v Woolcombers (1993) 27 ATR 302	Forward contract to buy wool still on sheep's backs	Cost **"incurred"** when contracts entered into, even though payment not yet due and no wool sold.
FCT v Energy Resources of Australia (2003) 135 FCR 346	Amendment sought to both closing and opening stock; statute of limitations (s 170 ITAA 1936) prevented prior-year amendment	Allsop J allowed opening-stock amendment; statute produces anomalies: "sometimes the taxpayer will be favoured; sometimes the revenue".

Legislative response to Woolcombers

The legislature did **not** modify the re-inclusion provision. Instead, **s 70-15** was enacted so the initial deduction is available only in the year the stock becomes "on hand".

TOPIC 10: Deductions – Depreciation (Division 40) & Tax Accounting

A. Depreciation of Machines and Equipment: Division 40

Overview and Policy

Under a comprehensive income tax, an outgoing for a short-term benefit is immediately deductible (revenue), while an outgoing for a longer-lived asset should be recognised over the period the benefits expire. If the asset does not waste, no deduction should be allowed; instead, the cost should be recognised in the cost base on disposal.

The judicial test distinguishing revenue from capital expenditure (process versus structure: *Sun Newspapers Ltd v FCT* (1939) 61 CLR 337) means that without specific statutory rules, "capital" expenses would not be recognised at all. Division 40 of the ITAA 1997 contains the general capital allowance regime for tangible (and some intangible) assets. Buildings are dealt with separately under Division 43.

The capital allowance rules in Division 40 apply where an expenditure is *capital* and hence not deductible under s 8-1. The operative provision is **s 40-25**, which allows a deduction for the *decline in value* of depreciating assets.

Section 40-25 (the operative provision)

ITAA 1997 s 40-25

- **s 40-25(1)** "You can deduct an amount equal to the decline in value for an income year (as worked out under this Division) of a *depreciating asset* that you *held* for any time during the year."
    - Two key conditions: deduction is only available (i) for the period you *held* the asset; and (ii) to the extent it was used for a *taxable purpose*.
    - Note 3 to s 40-25(1): generally only one taxpayer can deduct, but joint holders each deduct (s 40-35).
- **s 40-25(2) Reduction of deduction** "You must reduce your deduction by the part of the asset's decline in value that is attributable to your use of the asset, or your having it installed ready for use, for a purpose other than a *taxable purpose*."
    - Statutory example: Ben holds a depreciating asset used 30% for private purposes; if it declines by $1,000, deduction reduced by $300.
- **s 40-25(3) Further reduction: leisure facilities (trigger)**: "You may have to make a further reduction for a *depreciating asset that is a *leisure facility* attributable to your use of it, or your having it *installed ready for use*, for a *taxable purpose*."
- **s 40-25(4) Further reduction (operative rule)**: That reduction is the part of the leisure facility's decline in value attributable to your use of it, or having it installed ready for use, at a time when:
    - **(a)** its use did *not* constitute a *fringe benefit*; or
    - **(b)** you did not use it or hold it for use as mentioned in para 26-50(3)(b) (using it in the course of your business or for your employees).
- **s 40-25(5) Exception: low-value pools**: subss (2)–(4) do not apply to assets allocated to a low-value pool. You can continue to deduct decline in value even after you stop holding the asset.
- **s 40-25(7) Meaning of *taxable purpose***:
    - (a) the *purpose of producing assessable income*;
    - (b) the purpose of *exploration or prospecting*;
    - (c) the purpose of *mining site rehabilitation*;
    - (d) *environmental protection activities*.
- **s 40-25(8)**: special carve-out where Division 250 applies (asset taken not to be used for taxable purpose to the extent of disallowed capital allowance percentage).

Issue 1: Is this kind of asset a *depreciating asset*?

ITAA 1997 s 40-30

s 40-30(1) Definition: 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;
- (b) an item of trading stock; or

TOPIC 11: Entity Taxation – Partnerships, Trusts & Companies (Imputation)

A. INTRODUCTION TO ENTITY TAXATION

Why use an entity for an income-earning activity?

- **Ownership structure / capital raising**: a vehicle facilitates pooling of capital and tradeable interests
- **Limited liability**: companies and limited partnerships shield owners from business risk
- **Regulatory**: certain activities require a particular vehicle (eg managed investment trusts)
- **Tax planning**: rate arbitrage, income splitting between family members, deferral of tax on retained earnings
- **Asset protection**: trusts separate legal and beneficial ownership

Entity life cycle (relevant transactional points for tax)

Stage	Tax issues
Formation	Cash contributions; transfer of assets/liabilities from current owner
Operation	Treatment of earnings/losses; who is taxpayer; retention vs distribution; flow-through of source and character
Distributions	Taxed earnings; untaxed earnings; partial returns of capital
Reorganisations	Splitting/consolidating interests; varying rights attached
Termination	Disposal of interests; winding up

Three core problems where an intermediary is interposed (text [13.05])

- **Reconciling tax at two levels**: if taxable income is calculated at the entity level, must decide whether to tax the entity, and if so, how to relate that tax to tax on the owners
- **Dual cost base**: are owners' interests CGT assets separate from the entity's assets? If so, two cost bases exist in the same underlying assets, creating possibility of duplication of gains/losses
- **Locked-in losses**: if losses are incurred, are they locked in the entity (companies, trusts) or passed through to the owners (partnerships)?

Design questions for entity taxation

Question	Options
Who pays the tax?	Owners; entity; both
On what?	All income; earned income; distributed income; retained income
When?	When earned; when distributed

Tax policy options for taxing intermediaries

Option 1: Separate taxation ("classical system")

- Entity treated as a separate taxpayer for legal and tax purposes
- Income calculated and taxed at entity level
- Further tax triggered on distribution to investor
- Retained profits only taxed at investor level upon realisation (eg sale of shares)
- **Losses trapped** in the entity
- Tax concessions are lost upon distribution
- *Example*: corporate taxation in the United States

Option 2: Full integration ("fiscally transparent" / look-through to owner)

- **One level of tax only**, at investor level
- Income calculated at entity level
- Share of income taxed at investor level **regardless of distribution**

- May involve withholding tax on distribution
- Losses may also be allocated to investors
- *Example*: Australian taxation of partnerships, and trusts in some circumstances

Option 3: Partial integration ("imputation")

- Integration only as to **distributed** income
- Income calculated and taxed at entity level
- On distribution, investor is granted a credit (franking credit) for tax paid by entity
- Losses trapped at entity level
- Tax concessions lost on distribution
- Credit not available for retained profits; increase in value taxed on realisation
- *Example*: taxation of resident companies in Australia, corporate limited partnerships, and certain trusts taxed like companies

Option 4: Proxy

- Income calculated at entity level
- A person with the legal interest in the entity (eg the trustee) pays tax at a rate fixed by statute on behalf of the investor; this may not be the rate the investor would otherwise pay
- Investor not taxed on distribution (because tax has been paid as proxy)
- *Example*: trustee assessed under ss 98, 99 or 99A ITAA 1936

Option 5: Non-entity look-through

- Entity disregarded entirely
- Each investor calculates its own tax liability from a share of the income and outgoings
- Losses available to investors; each investor makes its own elections
- *Example*: non-entity joint ventures

Australian approach: bases of entity taxation under the ITAA

Entity	Basis
Company	Imputation (partial integration)
Partnership	Full integration (partnership not a tax-paying entity)
Joint venture	Non-entity (look-through)
Trust	Integration **or** proxy via trustee (trust estate not a tax-paying entity)

Policy/context (Henry Review, text [13.20])

- Different entity types create biases in choice of business structure; tax outcomes should be **broadly consistent** to limit such biases (with allowance for diverse circumstances)
- Variation across entity types in: how business income is taxed (more favourable treatment of capital gains and foreign source income for unincorporated entities), access to losses, and deferral benefits from retaining income in a company
- **Trust rules in particular are complex and uncertain**: differing views on key concepts ("present entitlement", "income of the trust estate", "share") create uncertainty, especially regarding capital gains and whether income retains character flowing through a trust
- Henry Review recommended retaining imputation in the short term, with longer-term consideration of alternatives. Government announcements in 2010 and 2011 indicated rewriting of trust rules and a review of corporate/shareholder taxation, but those projects are **defunct** and current rules are likely to survive

How are entities distinguished for tax purposes?

ITAA 1997 s 960-100: Meaning of "entity"

(1) *Entity* means any of the following:

- (a) an individual

- Written notice required; relates to documents in the recipient's custody or control.
- Notice must be sufficiently clear and precise.
- Failure to comply is an offence.

Duties of the Commissioner

- **Duty to collect the correct revenue:**
  - *Brown v C of T* [1999] FCA 563 [51]: the Commissioner "is obliged to collect tax in accordance with a correct assessment, that is to say, to collect the correct amount of tax, no more and no less."
  - *Lighthouse Philatelics v C of T* (1991) 32 FCR 148 at 155: the Commissioner's task is "to ensure that the correct amount of tax is paid, 'not a penny more, not a penny less'."
- **Duty of good management** under the PGPA Act: affairs "must be managed so as to promote the proper use and management of public resources" ("proper" = efficient, effective, economical and ethical).

Oversight bodies

- Australian National Audit Office (ANAO); Office of the Australian Information Commissioner (FOI); Commonwealth Ombudsman; **Inspector-General of Taxation and Taxation Ombudsman** (IGTO, since 2003, took over individual ATO complaints from the Ombudsman from 1 May 2015); House Standing Committee on Tax and Revenue; Senate Standing Committee on Economics; Joint Committee of Public Accounts and Audit.

Secrecy and the Taxpayer's Charter

- Strict secrecy provisions in TAA Sch 1 Div 355; disclosure permitted under s 355-50 in the performance of official duties or for civil tax-related proceedings (Item 3): *Jordan, Commissioner of Taxation v Second Commissioner of Taxation* [2019] FCA 1602.
- **Taxpayer's Charter** (1997, periodically reviewed): outlines rights under the law, ATO service standards, complaint avenues and taxpayer obligations. **Not legislated**; does not create new rights; has not received detailed judicial consideration. Contrast the US Taxpayer Bill of Rights.

A.3 Self-assessment system

- Introduced piecemeal from **1 July 1986**.
- Under self-assessment, lodgement of a tax return is treated as the assessment (and for full self-assessment taxpayers is **deemed** to be an assessment by the Commissioner: s 166A — see A.6 below).
- Taxpayer calculates and pays the tax with the return; ATO may issue a confirming notice or refund.
- ATO "in theory does not review the returns on lodgement but can do so by post assessment compliance activity."

Effect on balance of power and risk

- Fundamental shift in 1986: the taxpayer lost the certainty of pre-assessment ATO review and is "still in jeopardy at any time during the next two to four years, or possibly longer" (ie if fraud or evasion).
- Risk of **interest** (shortfall interest charge; general interest charge) and **administrative penalties** falls on the taxpayer.
- Cost savings for the ATO; greater burden on taxpayers (often without the skills to apply complex law to their circumstances) and on third-party reporters.

Compliance costs and third-party reporting

- Tax return for individuals grew from 6 pages (1996) to 12+ pages (2006) and continues to grow.
- Compliance cost studies estimate costs in excess of 10% of tax revenue collected.
- "Approved form" requirement (ITAA 1936 s 161A; TAA Sch 1 s 388-50) compels information in consistent format.
- Growing third-party reporting obligations centralised in Sch 1 TAA: Div 393 (TFN/ABN quoting; Pt VA investments), Subdiv 396-A (FATCA), Subdiv 396-B (state/territory real property transfers), Subdiv 396-C (Common Reporting Standards), Div 410 (building and construction industry), ASIC market integrity data, government-related entity reporting on grants/services.

C. Dispute Resolution

C.1 Framework: routes to challenge ATO decisions

Multiple avenues exist to review or challenge decisions and actions of the Commissioner:

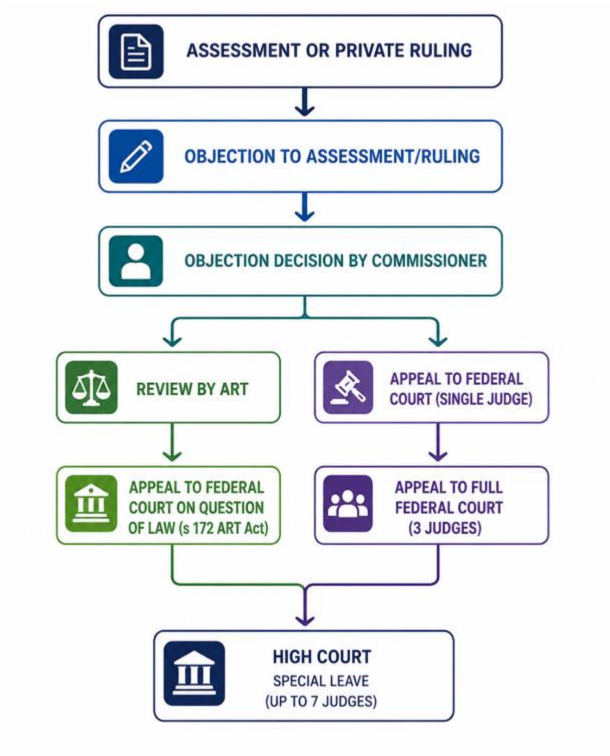
- **Complaints:** direct to ATO; alternatively to the Inspector-General of Taxation and Taxation Ombudsman (IGTO).
- **Judicial review:** was the decision within the law? Traditional grounds are illegality (beyond power), irrationality/unreasonableness, or failure of procedural due process/fairness.
  - Constitutional source: s 75(v) of the Constitution; Federal Court conferred jurisdiction via s 39B *Judiciary Act 1903* (Cth).
  - Some administrative decisions reviewable under ADJR Act.
  - **For assessment decisions:** judicial review grounds limited to **conscious maladministration/bad faith** due to ITAA 1936 s 175 (no-invalidity clause): *FCT v Futuris* [2008] HCA 32; *FCT v Donoghue* [2015] FCAFC 183 (covered in Part 1 A.9).
- **Merits review:** is the decision correct? Is the assessment excessive? Governed by ITAA 1936 s 175A and TAA Part IVC.
  - Implicit constitutional requirement that **a tax must not be incontestable**: Dixon J in *DFCT v Brown* [1958] HCA 2.

C.2 The Pt IVC process — overview

Stages:

1. Commissioner makes an assessment, determination, notice or decision for which a right of objection is provided.
2. Taxpayer **objects** within time limits, stating grounds fully and in detail.
3. Commissioner makes an **objection decision** (effectively a mandatory internal review).
4. Taxpayer may seek **review** of the objection decision by the **Administrative Review Tribunal (ART)** or **appeal** to the Federal Court.
5. From the ART, party may appeal to the Federal Court on a **question of law** (ART Act s 172).
6. From the Federal Court, party may appeal to the **Full Federal Court**.
7. Application for **special leave** may be made to the High Court.

Diagram of pathway:



the right to object against an assessment relating to the matter ruled or determined is limited to grounds that neither were, nor could have been, grounds for the prior objection.

s 14ZW — When taxation objections are to be made

- **(1)(aa) Income tax assessments:**
    - **(i)** if Item 1, 2, 3 or 3A of the s 170(1) table ITAA 1936 applies — **2 years after notice of the assessment**; or
    - **(ii)** otherwise — **4 years after notice of the assessment**.
- **(1)(ba) Failure to make a private ruling** under s 359-50(3) in Sch 1: **60 days** after the end of the 30-day period referred to in that subsection.
- **(1)(c) In any other case: 60 days after notice of the taxation decision has been served**.

Private rulings (cut-off)

- **(1A)** A taxation objection against a private ruling relating to a year of income cannot be lodged after the later of: 60 days after the ruling was made; or 2 years (if Item 1, 2, 3 or 3A applies to the person's assessment for that year) or 4 years (otherwise) after the last day for lodging a return for that year.

Interaction with amended-decision rule (s 14ZV)

- **(1B)** Where s 14ZV applies and the underlying time limit is 4 years: lodge before the later of (c) 4 years after notice of the unamended decision, or (d) 60 days after notice of the amended decision.
- **(1BA)** Where s 14ZV applies and the underlying time limit is 2 years: lodge before the later of (c) 2 years after notice of the unamended decision, or (d) 60 days after notice of the amended decision.

Late objections — extension request

- **(2)** If the period has passed, the person may nevertheless lodge with a written request that the Commissioner deal with the objection as if it had been lodged in time.
- **(3)** The request must state fully and in detail the circumstances concerning, and the reasons for, the failure to lodge within time.

s 14ZX — Commissioner to consider applications for extension of time

- **(1)** After considering the request, the Commissioner must decide whether to agree to it or refuse it.
- **(2)** The Commissioner must give the person written notice of the decision.
- **(3)** If the Commissioner agrees, the objection is taken to have been lodged within the required period.
- **(4)** If the Commissioner refuses, the person may **apply to the Tribunal for review** of the decision.

s 14ZY — Commissioner to decide taxation objections

- **(1)** Subject to subsection (1A), if the objection has been lodged within the required period, the Commissioner must decide whether to:
    - **(a)** allow it, wholly or in part; or
    - **(b)** disallow it.
- **(1A)** If the objection is under s 359-50(3) in Sch 1 against the Commissioner's failure to make a private ruling, the Commissioner must:
    - **(a)** make a private ruling in the same terms as the draft ruling lodged with the objection; or
    - **(b)** make a different private ruling.
- **(1B)** If the objection is under s 155-30(2) in Sch 1 against the Commissioner's failure to make an assessment of an assessable amount, the Commissioner must decide to make an assessment.
- **(2)** A decision under (1), (1A) or (1B) is an **objection decision**.
- **(3)** The Commissioner must cause to be served on the person written notice of the objection decision.

s 14ZYA — Person may require Commissioner to make an objection decision (deemed disallowance)

- **(1)** Applies if the taxation objection (other than under s 155-30(2) or s 359-50(3) in Sch 1) has been lodged within the required period and the Commissioner has not made an objection decision by the later of:
    - **(a)** the end of the original 60-day period (after the later of lodgement or decision to extend under s 14ZX); or

- (b) if the order is made by a higher constitution and no application for special leave to appeal to the High Court is made within 30 days — the order becomes final at the end of that period.

s 14ZZR — Pending appeal not to affect implementation of taxation decisions

The fact that an appeal is pending in relation to a taxation decision does not in the meantime interfere with, or affect, the decision and any tax, additional tax or other amount may be recovered as if no appeal were pending.

C.8 ART Act 2024

s 172 Party may appeal

- **(1)** A party to a proceeding in the Tribunal may appeal to the Federal Court, **on a question of law**, from the decision of the Tribunal in the proceeding.
  - *Note 1: Specific exceptions in the Child Support and Migration contexts (Federal Circuit and Family Court).*
  - *Note 2: Migration decisions may instead be reviewed in the Federal Court or FCFCA per ss 476 and 476A Migration Act 1958.*
- **(2)** To avoid doubt, subsection (1) **does not apply** in relation to a decision under s 128 ART Act (President decides whether to refer Tribunal decision to guidance and appeals panel).
  - *Note: A decision under s 128 is not a decision of the Tribunal.*

C.9 Substance of objections: content, grounds and the *Reynolds* problem

Form and content (TAA s 14ZU)

- No particular form of words is required; ordinary language is acceptable.
- *Lancey Shipping Co Pty Ltd v FCT* (1951) 9 ATD 267 (Williams J): "The grounds of objection need not be stated in legal form, they can be expressed in ordinary language, but they should be sufficiently exclusive to direct the attention of the [Commissioner] to the particular respects in which the taxpayer contends that the assessment is erroneous and his reasons for this contention. In each case the sufficiency of the grounds is a matter for the court. Vague grounds such as that the assessment is excessive are not, in my opinion, a compliance with the Act."
- Limit of informality: *Case Z28* (1992) 92 ATC 264 — a letter saying "we are in possession of your assessment ... and hereby wish to object to your assessment in full" is insufficient.

The "omnibus" objection problem

- ss 14ZZK and 14ZZO **limit the taxpayer to the grounds stated in the objection** (subject to the Tribunal/Court's discretion to allow amendment).
- Combined with the taxpayer's burden of proof, this has produced an unintended drafting practice: taxpayers draft "omnibus" objections asserting every conceivable argument, which confuses the real matters in issue.
- Discretion to add new grounds (not merely elaborate existing ones) confirmed by FFC in *Lighthouse Philatelics Pty Ltd v FCT* (1991) 22 ATR 707; 91 ATC 4942.

No equivalent restriction on the Commissioner

- *Danmark Pty Ltd v FCT* (1944) 7 ATD 333 (Latham CJ): if the Commissioner assesses under one section and the taxpayer is limited to the grounds in the objection, "it would be manifestly unfair to allow the Commissioner to support the assessment upon the basis of the provisions other than those which the Commissioner has stated to be the basis of the assessment."
- This position was **doubted** in *FCT v Reynolds*.

C.10 *FCT v Reynolds* — Commissioner's freedom to support assessment on a new basis

***FCT v Reynolds* (1981) 11 ATR 629; 81 ATC 4131 (Supreme Court of Tasmania, Neasey J)**

The Commissioner can support an assessment under a different statutory provision from that originally cited in the adjustment sheet, provided no injustice has been done to the taxpayer; and a careful taxpayer should draft objections to capture every plausible basis of assessment.
FACTS: The ATO assessed the taxpayer on the profit from the sale of a leased motor vehicle. The adjustment sheet accompanying the assessment stated the amount was assessable under the former s 26AAA ITAA 1936. The

TOPIC 13: Ethical Conduct & Rules to Counter Tax Avoidance

A. Ethical and Professional Responsibilities

1. The regulatory framework

Tax advisers in Australia are regulated by the *Tax Agent Services Act 2009* (Cth) (**TASA**), supplemented by the *Tax Agent Services Regulations 2022* (Cth) (replacing the 2009 Regulations). The regime is administered by the **Tax Practitioners Board (TPB)**, established under Div 60.

Three categories of regulated adviser must register:

- **Tax agents**: provide *tax agent services* (s 90-5)
- **BAS agents**: provide *BAS services* (s 90-10)
- **Tax (financial) advisers**: provide *tax (financial) advice services* (s 90-15)

Registration requirements are prescribed in Sch 2 to the Regulations and turn on a mix of qualifications, study, professional association membership and a prescribed period of relevant supervised experience.

2. The Code of Professional Conduct (TASA s 30-10)

Five categories of principles structure the Code. The provision must be stepped out in full because civil penalties attach to breach.

Honesty and integrity

- (1) You must act honestly and with integrity.
- (2) You must comply with the *taxation laws* in the conduct of your personal affairs.
- (3) If:
  - (a) you receive money or other property from or on behalf of a client; and
  - (b) you hold the money or other property on trust; you must account to your client for the money or other property.

Independence

- (4) You must act lawfully in the best interests of your client.
- (5) You must have in place adequate arrangements for the management of *conflicts of interest* that may arise in relation to the activities you undertake as a registered tax agent or BAS agent.

Confidentiality

- (6) Unless you have a legal duty to do so, you must not disclose any information relating to a client's affairs to a third party without your client's permission.

Competence

- (7) You must ensure that a tax agent service you provide, or that is provided on your behalf, is provided competently.
- (8) You must maintain knowledge and skills relevant to the tax agent services you provide.
- (9) You must take reasonable care in ascertaining a client's state of affairs, to the extent that it is relevant to a statement you are making or a thing you are doing on behalf of the client.
- (10) You must take reasonable care to ensure that *taxation laws are applied correctly* to the circumstances in relation to which you are providing advice.

Other responsibilities

- (11) You must not knowingly obstruct the proper administration of the taxation laws.
- (12) You must advise your client of the client's rights and obligations under the taxation laws that are materially related to the services you provide.
- (13) You must maintain professional indemnity insurance that meets the Board's requirements.
- (14) You must respond to requests and directions from the Board in a timely, responsible and reasonable manner.

Mental element of taxpayer / agent	Penalty (% of shortfall)
Recklessness	50%
Intentional disregard	75%

Where there is NO shortfall amount (eg the false statement did not produce a tax shortfall but still attracts penalty under s 284-75(1) or (4)):

Mental element	Penalty
Negligence	20 penalty units
Recklessness	40 penalty units
Intentional disregard	60 penalty units

Base penalty amount adjustments:

- **Reasonably arguable position**: reduces the base penalty
- **Voluntary disclosure** to the ATO: reduces the base penalty
- **Hindering** ATO investigations: increases the base penalty

Key concept — "reasonably arguable": a position is reasonably arguable if it would be concluded that the argument that the way in which the law applied was about as likely to be correct as the contrary view. Where the position is reasonably arguable, the 25% "not reasonably arguable" penalty in s 284-75(2) is avoided.

4. s 284-145 — Liability to penalty (schemes: Subdiv 284-C)

s 284-145(1) — You are liable to an administrative penalty if:

- (a) you would, apart from a provision of a taxation law or action taken under such a provision (the adjustment provision), get a scheme benefit from a scheme; and
- (b) having regard to any relevant matters, it is reasonable to conclude that:
  - (i) an entity that (alone or with others) entered into or carried out the scheme, or part of it, did so with the **sole or dominant purpose** of that entity or another entity getting a scheme benefit from the scheme; or
  - (ia) for a scheme to which Part IVA of the ITAA 1936 applies because of section 177DA of that Act (MAAL), an entity that (alone or with others) entered into or carried out the scheme, or part of it, did so for a **principal purpose** of, or for more than one principal purpose that includes a purpose of, that entity or another entity getting a scheme benefit from the scheme; or
  - (ii) for a scheme referred to in Division 165 of the GST Act or Division 75 of the Fuel Tax Act 2006, the **principal effect** of the scheme, or of part of the scheme, is that you would, apart from the adjustment provision, get the scheme benefit from the scheme directly or indirectly.

s 284-145(2A) — You are also liable to an administrative penalty if:

- (a) you would, apart from a determination under section 815-30 of the Income Tax Assessment Act 1997 (also the adjustment provision), get a scheme benefit from a scheme; and
- (b) neither subparagraph (1)(b)(i) nor subparagraph (1)(b)(ia) is satisfied for the scheme.

s 284-145(2B) — You are also liable to an administrative penalty if:

- (a) to give effect to Subdivision 815-B or 815-C of the Income Tax Assessment Act 1997 (also the adjustment provision) in relation to a scheme, the Commissioner:
  - (i) amends your assessment for an income year; or
  - (ii) serves you with one or more notices under subsection 128C(7) of the ITAA 1936 in respect of income that is taken because of the application of the adjustment provision to have been derived in the income year; and
- (b) as a result, you are liable to pay an additional amount of income tax or withholding tax (as the case requires).

  - Carve-outs: mere advice (s 290-60(2)); employee mere distribution (s 290-60(3))
4. **Conduct prohibited**: s 290-50(1) (promoter of tax exploitation scheme), (1A) (promoting contrary to ruling), or (2) (implementing contrary to ruling).
5. **Exceptions**: reasonable mistake of fact (s 290-55(1)(a)); cause beyond control + reasonable precautions and due diligence (s 290-55(1)(b)); reliance on Commissioner's guidance (s 290-55(3)); did not know and could not reasonably be expected to know (s 290-55(7)); employer already penalised (s 290-55(8)).
6. **Time limit**: 6 years from last conduct (s 290-55(4) and (5)) — does not apply to tax evasion (s 290-55(6)).
7. **Quantum**: greater/greatest of penalty units, 3× benefits, 10% aggregated turnover (capped at 2.5m penalty units). Distinguish individual (s 290-50(4)), body corporate (s 290-50(4A)), and SGE partnership/trust (s 290-50(4B)).
8. **Court considerations** (s 290-50(5)): benefit amount, deterrence, participant loss, nature/extent, deliberateness, period, steps to avoid, prior conduct, cooperation.
9. **Alternative remedies**: injunctions under Subdiv 290-C; voluntary undertakings under s 290-200.

9. Comparison: GAAR purpose v promoter penalty purpose

Provision	Purpose threshold
s 177D ITAA 1936 (general Pt IVA)	Sole or dominant purpose
s 177DA ITAA 1936 (MAAL)	Principal purpose
s 177J ITAA 1936 (DPT)	Principal purpose
s 177EA ITAA 1936 (franking credit schemes)	A purpose (not incidental)
s 284-145(1) Sch 1 TAA (scheme penalty, general)	Sole or dominant purpose
s 284-145(1)(ia) (scheme penalty, MAAL)	Principal purpose
s 290-65(1) Sch 1 TAA (promoter, general)	Sole or dominant purpose
s 290-65(1A) Sch 1 TAA (promoter, MAAL/DPT)	Principal purpose

The progression from "sole or dominant" → "principal" → "a purpose (not incidental)" reflects increasing legislative concern about more deeply embedded or harder-to-prove avoidance behaviour.

- **REASONING:** The product was a *combination food* of which at least one component (biscuits/confectionary) is specified in Sch 1. AAT rejected the argument it was a single supply of flavoured yoghurt.

***Simplot Australia Pty Ltd v FCT* [2023] FCA 1115**

- **ISSUE:** Were frozen vegetables (some with grains, spices, seasonings) GST-free?
- **HELD:** Not GST-free.
- **REASONING:** "Food of a kind marketed as a prepared meal" under Sch 1.

Beverages (Schedule 2 — highlights)

GST-free beverages include: milk products; soy/rice milk; tea and coffee (not ready-to-drink); fruit and vegetable juices; beverages for infants/invalids; natural non-carbonated water without additives.

Health (Subdiv 38-B)

s 38-7 — Medical services

(1) A supply of a *medical service* is GST-free.
(2) However, a supply of a *medical service* is not GST-free under subsection (1) if:

- (a) it is a supply of a *professional service* rendered in circumstances covered by a prescribed provision of regulations made under the *Health Insurance Act 1973*; or
- (b) it is rendered for cosmetic reasons and is not a *professional service* for which medicare benefit is payable under Part II of the *Health Insurance Act 1973*.

(3) A supply of goods is GST-free if:

- (a) it is made to an individual in the course of supplying to him or her a *medical service* the supply of which is GST-free; and
- (b) it is made at the premises at which the medical service is supplied.

s 38-10 — Other health services

(1) A supply is GST-free if:

- (a) it is a service of a kind specified in the table in this subsection, or of a kind specified in the regulations; and
- (b) the supplier is a *recognised professional* in relation to the supply of services of that kind; and
- (c) the supply would generally be accepted, in the profession associated with supplying services of that kind, as being **necessary for the appropriate treatment** of the *recipient* of the supply.

Table of health services (s 38-10(1)):

Item	Service
1	Aboriginal or Torres Strait Islander health
2	Acupuncture
3	Audiology, audiometry
4	Chiropody
5	Chiropractic
6	Dental
7	Dietary
8	Herbal medicine (incl. traditional Chinese)
9	Naturopathy
10	Nursing
11	Occupational therapy
12	Optometry
13	Osteopathy

THE DIRECTORY

Use this during reading time. For every receipt, transaction, or question, work through this directory first. It tells you exactly which module to open and what to look for before you start typing.

STEP 1: Label Every Question

Read every question and write one label next to it on the question paper.

What the question looks like	Label	Go to
Given assessable income, deductions, offsets: calculate tax	CALC	Module A
"Is this ordinary income?" / conceptual income scenarios	INCOME	Module B
Property bought and sold, cost base, capital gain or loss	CGT	Module D
Compensation, damages, insurance, settlement received	COMP	Module E
Employee receives a benefit, ticket or car; employer provides a non-cash benefit	FBT	Module C
Hobby vs business, athlete, land development, isolated transaction, restrictive covenant	BUSINESS	Module F
"Is this a tax?" / "Is this progressive?" / "Is this an income tax?" / MCQ policy	POLICY	Module G
An expense or loss; "is this deductible?"; travel, self-education, legal costs, home office, fines, damages	DEDUCT	Module H
Outgoing acquires or protects an asset or structure; "capital or revenue?"	DEDUCT-CAP	Module H6
Business asset bought/held/sold (stock, equipment, plant); "how is the cost recovered?"; or a timing question (which year, cash vs accruals, prepayment, provision)	ASSET / TIMING	Module I
Income earned through an interposed entity (partnership, trust, company, joint venture), or a distribution from one	ENTITY	Module J
Assessment validity or timing; amendment; objection or appeal; ATO access/information powers; rulings; privacy	ADMIN	Module K
Artificial or contrived arrangement; tax avoidance; Part IVA; sham; dividend stripping; franking-credit scheme	AVOID	Module L
Administrative penalty; false or misleading statement; shortfall; scheme penalty; "reasonably arguable"	PENALTY	Module M
Tax agent/BAS agent conduct; registration; Code of Conduct; false statement by an adviser; marketing or promoting a scheme	ADVISER	Module N
GST on a supply or acquisition; registration; taxable supply; ITCs; GST-free vs input taxed; importation; BAS	GST	Module O

STEP 2: Run the Decision Tree

Do this during reading time for each item in every question.

Gateway (run before the receipt/outgoing tree)
Is this a machinery, entity, or adviser question rather than a substantive characterisation?

- **Machinery** around an assessment (was a valid assessment made, when is tax due, can the Commissioner amend, how does the taxpayer object or appeal, ATO powers, rulings, privacy) → **ADMIN → Module K**, run K1 → K6.
- **Adviser's professional conduct**, or the **marketing or promotion of a scheme** → **ADVISER → Module N** (run both N1 and N2 where an adviser markets a scheme).

Otherwise continue.

Threshold: is the item a receipt, an outgoing, a business asset, or earned through an entity?

- **Outgoing / loss / expense** → **Module H.** Run positive limbs (H1) → temporal nexus (H2) → apportionment (H3) → negative limbs. Capital issue → H6 then H7. Private/domestic → H5. Specific prohibition (fine, entertainment, relative's travel) → H4.
- **Business asset** (bought / held / sold) → **Module I.** Which regime: held for sale in the ordinary course → Div 70 (I1–I5); used and wasting → Div 40 (I6–I11); building → Div 43 (I12); non-wasting capital → CGT (Module D); consumed at once → s 8-1 (Module H).
- **Interposed entity** (partnership, trust, company or joint venture) earns the income or makes a distribution → **Module J.** Run the hub routing tree, determine *who* is taxed and *how much*, then return to this tree to characterise the underlying income.
- **Receipt** → continue with the receipt tree below (First → Fifth).

First: Who received it?

Character is assessed in the recipient's hands, not anyone else's. Note who the taxpayer is and in what capacity they received the amount. If the amount was derived through an interposed entity, divert to **Module J** first to fix who is assessed and in what proportion; the character tests are then applied at the entity level (eg s 90 net income "as if a resident taxpayer"; s 95 trust net income) and flow out.

Second: Is it ordinary income under s 6-5? Ask all four:

- Has it come home to the taxpayer? (realised, not a future right)
- Is there a real gain, or does it merely restore them?
- Was it received for their own benefit, not as trustee or agent?
- Is it convertible to cash? (only relevant if non-cash)

If all four: identify the category (Step 3) and go to the relevant module.

Third: If not ordinary income, check statutory income:

- Employment benefit? → **Module C** (s 15-2)
- Business subsidy or grant? → **Module F** (s 15-10)
- Profit from a scheme involving pre-1985 property or a no-sale transaction? → **Module F** (s 15-15)
- CGT event occurred? → **Module D**

Fourth: Both ordinary income AND a CGT event from the same facts?

→ s 118-20 reduces the capital gain. Go to **Module D, Section D4**.

Fifth: Employment context?

Always ask: is this a fringe benefit? → **Module C.** If yes: NANE to the employee (s 23L ITAA 1936), FBT on the employer. If no: ordinary income or s 15-2.

Timing

Whenever a receipt or outgoing raises *when* (not *whether*), branch to **Module I (I13–I17)** for the timing answer, then return to the substantive module.

Overlays (run after the substantive analysis)

- **Anti-avoidance:** if the arrangement looks artificial or contrived, or the question raises Part IVA → **AVOID → Module L.** Run L1 sham → L2 s 8-1 (*Fletcher*) → L3 TAAR → L4 Part IVA.
- **Penalty:** once an assessment is increased (a shortfall), a false or misleading statement is made, or Part IVA/a scheme provision applies → **PENALTY → Module M** (and the promoter penalty for an adviser → Module N).
- **GST is parallel:** if the item is a supply, acquisition or importation by a registered (or registrable) entity, also label **GST → Module O** and answer that regime separately.

STEP 3: Category Identification Table

Once you confirm something is ordinary income, identify the category:

Receipt looks like...	Category	Go to
Wages, salary, bonus, reward for work done	Services	Module C
Interest, rent, royalties	Property	Module B (state directly)
Profits from a business, gains from a trade	Business	Module F
Payment substituting for something that would have been income	Compensation	Module E
Regular recurring payments relied on for living	Periodic	Module B (Prop 11)
Pure gift, lottery win, gambling win	Gift / Windfall	Module B (Prop 8/9, not income)
Gain on sale of an asset	Capital	Module D (CGT)

A partnership, trust or company distribution is **not** a new category of ordinary income: character is determined at the entity level (Module J) and flows through, so this table still governs the underlying income.

QUICK REFERENCE: MODULE DIRECTORY

Facts say...	Module
Calculate income tax payable	A
Is this ordinary income? Conceptual scenarios	B
Non-cash benefit, convertibility question	B Element 4
Salary directed to a third party	B Element 1 (constructive receipt)
Salary directed to a super fund	B Element 1 (super exception)
Interest, rent, royalties	B (property, state directly)
Regular recurring payments relied on for living	B (Prop 11)
Pure gift, lottery win, gambling win	B (Prop 8/9)
Non-cash property received for services (not business)	B Element 4 (s 21 ITAA 1936)
Employee receives a benefit / concert ticket / car	C
Is this a fringe benefit? Who pays? What value?	C3
Employee chooses between cash and a benefit	C4
Payment for varying or cancelling a service contract / restrictive covenant	C5
Cash allowance vs employer reimbursement	C3 Step 1
Waived loan establishment fees	C3 Step 2 (*Westpac*)
Property bought and sold; cost base calculation	D
CGT event identification (disposal, loss, right created)	D1
Both ordinary income and a CGT event from the same facts	D4 (s 118-20)
Main residence, dwelling sold	D5
Inherited asset on death / transfer to a beneficiary	D7 (Div 128)
Asset transferred to a spouse on relationship breakdown	D7 (s 126-5)
Asset destroyed or compulsorily acquired, replacement bought	D7 (ss 124-70 to 124-85)
Artwork, jewellery, coins, stamps	D6 (collectables, Subdiv 108-C)
Boat, private car, furniture	D6 (personal use assets, Subdiv 108-B)
Compensation, damages, insurance, settlement	E
Refund of a previously deducted expense	E3 (Div 20)
Lump sum covers deductible and non-deductible claims	E3 (s 20-25(4))
Hobby vs business, gambling, elite athlete	F1

MODULE A: BASIC CALCULATION

When to open: Question gives you assessable income, deductions, and offsets and asks you to calculate tax payable.

What to watch for:

- Imputation credits = tax *offsets*, not deductions. They reduce income tax dollar-for-dollar but cannot touch the Medicare levy.
- Non-refundable offsets bring income tax to zero but no further. Refundable offsets (like imputation credits) are refunded if they exceed the tax liability.
- Medicare levy is always 2% of taxable income, calculated separately, always added on top. Tax offsets do not reduce it.
- HECS/HELP is also calculated separately if mentioned. Ignore the 2% Medicare levy for the Danny/Conor problem as instructed.

Rate table (2025-26, resident individual):

Taxable income	Rate
$0 to $18,200	Nil
$18,201 to $45,000	16c per $1 over $18,200
$45,001 to $135,000	$4,288 + 30c per $1 over $45,000
$135,001 to $190,000	$31,288 + 37c per $1 over $135,000
$190,001+	$51,638 + 45c per $1 over $190,000

Companies: generally 30%.

COPY-PASTE: Module A

Work through each step and fill in the numbers. Delete any steps that are not relevant.

Under s 4-15(1) ITAA 1997, taxable income equals assessable income minus allowable deductions. Under s 4-10(3) ITAA 1997, income tax payable equals taxable income multiplied by the applicable rate scale, minus tax offsets.

Step 1: Taxable income Assessable income: $[INSERT] Less allowable deductions: $[INSERT] Taxable income: $[INSERT]

Step 2: Income tax on taxable income Applying the 2025-26 rate scale under the Income Tax Rates Act 1986: [INSERT bracket base amount] + [INSERT rate] x ([INSERT taxable income] − $[INSERT threshold]) = $[INSERT income tax before offsets]

Step 3: Tax offsets Less [INSERT type of offset, eg imputation credits / LITO]: $[INSERT] Income tax payable: $[INSERT]
(Note: if offsets exceed income tax, income tax = zero. Refundable offsets such as imputation credits are refunded to the extent they exceed the tax liability.)

Step 4: Medicare levy $[INSERT taxable income] × 2% = $[INSERT] *(Tax offsets do not reduce the Medicare levy: the Medicare levy is calculated separately on taxable income regardless of offsets.)*

Step 5: Total tax payable Income tax payable: $[INSERT] Plus Medicare levy: $[INSERT] **Total: $[INSERT]**

MODULE B: ORDINARY INCOME ANALYSIS

When to open: Any question asking whether a receipt is ordinary income, or any receipt that needs to be characterised before applying a specific module. Always run this analysis before opening any other module. This is the foundation of every income question.

What to watch for:

- The question is always: what is the character of this receipt *in the hands of this taxpayer*?
- Run all four elements in order. Briefly dismiss any that are clearly not in dispute.
- The non-convertible benefit issue (Element 4) only arises for non-cash receipts.
- The "beneficially received" issue (Element 3) only arises if there is a trustee or agency argument.
- Constructive receipt (s 6-5(4)) arises when income is directed to a third party.
- Super directions are different from other third-party directions: see Element 1 note.

COPY-PASTE: B1 Opening Paragraph

Use this as your opening paragraph for any ordinary income analysis.

The threshold question is whether [INSERT: describe the receipt, eg "the payment of $X received by [TAXPAYER]"] constitutes ordinary income within the meaning of s 6-5(1) ITAA 1997, which includes in a taxpayer's assessable income "income according to ordinary concepts." As Jordan CJ stated in *Scott v Commissioner of Taxation (NSW)* (1935) 35 SR (NSW) 215 at 219, the word "income" is not a term of art and is determined "in accordance with the ordinary concepts and usages of mankind" unless the statute indicates otherwise. The character of the receipt must be assessed in the hands of [INSERT: taxpayer's name] as the actual recipient, without regard to how it would have been characterised in another person's hands: Parsons' Proposition 3; *Federal Coke Co Pty Ltd v FCT* (1977) 7 ATR 519 per Bowen CJ at 388.

Element 1: Flow and Realisation

What to look for:

- Has the income actually arrived, or is it still just a right to receive something in the future? A future right is not yet taxable.
- Has it been directed to a third party at the taxpayer's instruction? That still counts as derived (constructive receipt, s 6-5(4)).
- Has it been directed to a *superannuation fund*? That is different: no income at the time of contribution (Constable).
- Cash basis (employees): derived when actually received. Accruals basis (businesses): derived when the right to receive arises.

COPY-PASTE: Element 1 (standard - income has arrived)

[INSERT: describe the receipt] has been received by [INSERT: taxpayer] and has "come home" to them: Parsons' Proposition 1. This element is satisfied.

COPY-PASTE: Element 1 (constructive receipt - directed to third party)

Although [INSERT: amount] was directed to [INSERT: third party] rather than paid directly to [INSERT: taxpayer], under s 6-5(4) ITAA 1997 a taxpayer is taken to have derived income "as soon as it is applied or dealt with in any way on [their] behalf or as [they] direct." [INSERT: taxpayer]'s direction to pay to [INSERT: third party] does not prevent derivation: *Gair v FCT* (1944) 71 CLR 388 per Latham CJ. The amount remains assessable to [INSERT: taxpayer].

COPY-PASTE: Element 1 (superannuation direction - different result)

[INSERT: taxpayer] directed [INSERT: amount] to a complying superannuation fund rather than receiving it personally. Directing salary to a complying superannuation fund does not trigger constructive receipt. The employee has only a

MODULE C: INCOME FROM SERVICES AND FBT

When to open: A receipt arises in an employment or services context. Work through C1 first (ordinary income), then C2 (s 15-2 fallback), then C3 (FBT) only if the benefit might be a fringe benefit.

C1: The Nexus Test for Ordinary Income (s 6-5)

What to look for:

- Is there a real and traceable connection between the receipt and the taxpayer's income-producing activities?
- Was the payment motivated by personal goodwill or personal relationship? → Not income (Hayes, Scott).
- Was the payment a substitute for salary at the same level? → Income even if voluntary (Dixon).
- Was the payment from a former employer with only a historical connection? → Not income (Harris).
- Was the payment from a third party with no arrangement with the employer? → Check if s 15-2 applies (Holmes, Payne).

The spectrum:

Employment's role	Result
Sole and motivating cause of the payment	Clearly ordinary income
One of several important causes	Likely ordinary income
One of many causes, no special importance	Uncertain, weigh all facts
Payment motivated by personal relationship alone	Not income (Scott, Hayes)
Voluntary payment substituting for salary, same periodicity	Income (Dixon principle)
Historical employment connection only	Not income (Harris)

COPY-PASTE: C1 - Receipt is income from services

[INSERT: receipt] is assessable as ordinary income under s 6-5(1) ITAA 1997 as a reward for services rendered by [INSERT: taxpayer]: Parsons' Proposition 13. The question is whether there is a sufficient nexus between [INSERT: receipt] and [INSERT: taxpayer]'s income-producing activities: *Hayes v FCT* (1956) 96 CLR 47 at 54 per Fullagar J; *Scott v FCT* (1966) 117 CLR 514 at 527 per Windeyer J. [INSERT: employment / services] [was / were] the [sole / motivating / substantial] cause of the payment. The receipt is a product of [INSERT: taxpayer]'s income-earning activities and is assessable.

COPY-PASTE: C1 - Gift argument, not income (Hayes/Scott)

Although [INSERT: payer]'s payment to [INSERT: taxpayer] arose in the context of a [employment / professional] relationship, a voluntary payment is prima facie not income: Parsons' Proposition 8. Further facts must show the payment is "in substance and in reality, not a mere gift but the product of an income earning activity": *Hayes v FCT* (1956) 96 CLR 47 at 54 per Fullagar J. The distinction is between a gift referable to the *personal relationship* between donor and donee, and a payment referable to *services rendered*: *Scott v FCT* (1966) 117 CLR 514 at 527-528 per Windeyer J. Here, [INSERT: payer]'s payment was motivated by [personal goodwill / gratitude / friendship], not by [INSERT: taxpayer]'s services. It is "impossible to relate the receipt... to any income-producing activity" of [INSERT: taxpayer]: *Hayes* at 56. The payment is not ordinary income.

COPY-PASTE: C1 - Voluntary payment substituting for salary (Dixon principle)

Although [INSERT: payments] were voluntary and not contractually required, they were periodic, relied upon by [INSERT: taxpayer] for living expenses, and substituted for [INSERT: taxpayer]'s [salary / income] at the same level. A voluntary payment that substitutes for income acquires the character of that which it substitutes: *FCT v Dixon* (1952) 86 CLR 540 per Fullagar J at 567-568. The payments are ordinary income under s 6-5(1) ITAA 1997 even though not legally required: per Dixon CJ and Williams J at 557.

Key exclusions to check:

- Cash salary: para (f), never a fringe benefit, assessed as ordinary income
- *Allowance vs reimbursement distinction:* An *allowance* paid to an employee in cash (eg a travel allowance or a meal allowance) is salary or wages excluded under para (f) and assessed as ordinary income to the employee, not FBT. A *reimbursement* (where the employer pays for a specific expense incurred by the employee) may be an expense payment fringe benefit assessable to the employer under FBT: *Roads and Traffic Authority of NSW v FCT* (1993) 43 FCR 223 per the Full Federal Court. Ask: did the employee receive a fixed periodic sum regardless of actual expenditure (allowance = ordinary income) or was the employer paying a specific third-party cost incurred by the employee (reimbursement = potential FBT)?
- Minor benefit under $300: potentially exempt under s 58P FBTAA
- Work-related items (laptop, phone): exempt under s 58X FBTAA
- Super contributions: excluded under para (j)
- ETPs: excluded under para (lc)

COPY-PASTE: Step 1 Analysis

[INSERT: benefit] must be assessed against the five elements of the s 136(1) FBTAA definition of "fringe benefit."

Element 1 (benefit): [INSERT: benefit] is a [right / privilege / service / facility] and falls within the broad definition of "benefit" in s 136(1) FBTAA. [This element is satisfied / is not satisfied because INSERT reason.]

Element 2 (provided): [INSERT: employer] [allowed / conferred / gave / granted] [INSERT: benefit] to [INSERT: employee]. [This element is satisfied / Note: under s 148(3) FBTAA, a nominal prohibition not consistently enforced does not prevent provision. INSERT: employer]'s [prohibition / policy] is not consistently enforced and [INSERT: benefit] is deemed to have been provided.]

Element 3 (to employee or associate): [INSERT: recipient] is a [current / former / future] employee of [INSERT: employer]. [If associate: [INSERT: recipient] is an associate of [INSERT: employee] within s 318 ITAA 1936 as a [relative / related company].] This element is satisfied.

Element 4 (by employer, associate, or arranger): [INSERT: benefit] was provided [directly by [INSERT: employer] / by [INSERT: third party] under an arrangement within s 136(1) FBTAA between [INSERT: employer] and [INSERT: third party]]. [If no arrangement: As in *Payne v FCT* (1996) 66 FCR 299, there was no arrangement between [INSERT: employer] and [INSERT: third party]. [INSERT: third party] acted under its own commercial scheme. This element is not satisfied and no FBT arises.]

Element 5 (in respect of employment): There is a "nexus, some discernible and rational link, between the benefit and employment": *J & G Knowles v FCT* (2000) 44 ATR 22. Under s 148(1)(g) FBTAA, the nexus is not broken merely because [INSERT: benefit] is not in the nature of income. [INSERT: benefit] was provided to [INSERT: employee] because of their employment with [INSERT: employer]. This element [is / is not] satisfied.

Exclusions: [INSERT: benefit] [is / is not] excluded from the definition of "fringe benefit." [Cash salary is excluded under para (f) / Minor benefit under $300 may be exempt under s 58P / Work-related item exempt under s 58X / Super contributions excluded under para (j) / DELETE inapplicable options.]

Conclusion: All five elements [are / are not] satisfied and [INSERT: benefit] [is / is not] excluded. [INSERT: benefit] [is / is not] a fringe benefit within s 136(1) FBTAA. [If fringe benefit: Under s 23L(1) ITAA 1936, [INSERT: benefit] is non-assessable non-exempt income (NANE) in [INSERT: employee]'s hands. FBT is assessed on [INSERT: employer] under s 66(1) FBTAA.]

Step 2: Taxable Value

What to look for first: What type of benefit is it? Match to the correct Division. Then check the otherwise deductible rule.

MODULE D: CGT ANALYSIS

When to open: An asset has been disposed of, lost, destroyed, or a contractual right has ended or been created. Also runs as a secondary analysis whenever something is not ordinary income.

Every CGT problem follows this sequence. Work through every step in order before moving to D1, D2 etc.

MASTER SEQUENCE: CGT PROBLEM

STAGE 1: Is CGT even in play?

Ask two threshold questions before doing anything else.

- Is the asset a **CGT asset** under s 108-5 ITAA 1997? (Any property, or any legal or equitable right that is not property. If no: stop, CGT does not apply.)
- Was the asset acquired **on or after 20 September 1985**? (If acquired before that date: pre-CGT asset, any gain is disregarded under s 104-10(5). If yes: CGT applies, continue.)

STAGE 2: Is there also ordinary income from the same transaction?

Ask this before calculating anything. If the same event produces both ordinary income and a CGT gain, you need to know this upfront because s 118-20 will reduce the capital gain at the end.

- Is the receipt already assessable as ordinary income under s 6-5 or statutory income under s 15-2 or s 15-15?
- If yes: flag s 118-20 now. You will come back to it after calculating the gain.
- If no: proceed normally.

STAGE 3: Identify the CGT event (→ D1)

What happened to the asset? Match to the correct event.

What happened	Event	Timing
Asset sold or transferred	A1 (s 104-10)	Date contract made, not settlement
Asset lost or destroyed	C1 (s 104-20)	When compensation first received, or when loss/destruction occurred
Intangible asset ended (cancelled, surrendered, discharged, expired)	C2 (s 104-25)	When contract for ending made, or when ownership actually ends
Taxpayer created a right in someone else	D1 (s 104-35)	When contract entered, or when right created
Money received relating to an asset, nothing else fits	H2 (s 104-155)	Most residual, only if no other event applies

If more than one event could apply: use the most specific under s 102-25(3). D1 before H2. D1 and H2 only if no other event (A1, C1, C2) applies.

Note for D1 and H2: gain = **capital proceeds minus incidental costs only** (no full cost base, because no pre-existing asset was disposed of). Skip Stage 4 and go straight to Stage 5 for D1 and H2.

STAGE 4: Calculate the cost base and capital proceeds (→ D2)

Cost base (s 110-25 ITAA 1997):
Element 1: Purchase price paid. Element 2: Incidental acquisition and disposal costs (stamp duty, legal fees, agent's commission). Element 3: Ownership costs (interest, insurance, maintenance, rates). **Only included if the asset was NOT used to produce assessable income AND the costs were NOT deductible under s 8-1.** If the property was rented out: element 3 = nil (anti-double-dipping rule, s 110-45(1B)). Element 4: Capital improvements. Element 5: Title defence costs.

MODULE E: COMPENSATION RECEIPTS

When to open: A payment is described as compensation, damages, insurance proceeds, a settlement, or a refund of previously deducted expenses.

E1: The Golden Rule and Character Test

What to look for:

- What did the payment *compensate for*? Not: how was it calculated?
- Income → lost income, temporary hole in profits, substitute income stream (Phillips, Liftronic, Smith).
- Capital → earning capacity itself, reputation/goodwill, entire business structure (Slaven, Sydney Refractive, Van den Berghs, Spedley).
- Mixed settlement → can it be apportioned? If not: entire amount is capital (McLaurin, CSR).
- Insurance → what was the *purpose* of the policy? (Smith, Carapark).

COPY-PASTE: E1 Opening

The character of [INSERT: compensation receipt] is determined by what it compensates for: Parsons' Proposition 15. A compensation receipt takes the same character as the thing it replaces. The method of calculating the amount does not determine its character. As Dixon and Evatt JJ stated in *C of T (Vic) v Phillips* (1936) 55 CLR 144, "to treat a sum of money as income because it is computed or measured by reference to loss of future income is an erroneous method of reasoning."

COPY-PASTE: E1 - Income (substituting for income stream, Phillips)

[INSERT: payment] substitutes for [INSERT: describe what was given up, eg monthly management fees / salary]. [INSERT: taxpayer] exchanged a right to [INSERT: periodic income] for [INSERT: replacement payments] of the same [periodicity / duration / estimated amount]. Where one income stream is exchanged for another of equivalent periodicity, duration, and estimated amount, the replacement retains the income character of what it replaces: *C of T (Vic) v Phillips* (1936) 55 CLR 144 per Dixon and Evatt JJ. [INSERT: payment] is ordinary income under s 6-5(1) ITAA 1997.

COPY-PASTE: E1 - Income (temporary hole in profits, Liftronic)

[INSERT: damage / event] temporarily impaired [INSERT: taxpayer]'s [business / earning activities]. [INSERT: taxpayer]'s earning capacity was not permanently destroyed; the business recovered. [INSERT: payment] fills a "hole in profits" during the period of impairment: *Liftronic Pty Ltd v FCT* (1996) 96 FCR 175. Where damages compensate for temporary impairment rather than permanent destruction of earning capacity, they are income. [INSERT: payment] is ordinary income under s 6-5(1) ITAA 1997.

COPY-PASTE: E1 - Capital (impairment of earning capacity, Slaven)

[INSERT: payment] compensates for [INSERT: statutory language or description, eg the "deprivation or impairment of earning capacity" of [INSERT: taxpayer]]. Earning capacity is a capital asset. [INSERT: payment] compensates for the impairment of the asset that *produces* income, not for the loss of income itself. Capital receipts. Not ordinary income under s 6-5: *FCT v Slaven* (1984) 1 FCR 11 per Bowen CJ, Lockhart and Sheppard JJ. [Note: The statutory purpose of a payment is "a powerful, though not conclusive" aid to characterisation.]

COPY-PASTE: E1 - Capital (reputation/goodwill, Sydney Refractive/Spedley)

[INSERT: payment] compensates for injury to [INSERT: taxpayer]'s [reputation / goodwill]. Reputation and goodwill are capital assets: they are part of what enables [INSERT: taxpayer] to earn income, not income itself. The nature of the *cause of action* determines character, not the method of calculating quantum: *FCT v Sydney Refractive Surgery Centre Pty Ltd* (2008) 172 FCR 557 per Ryan, Edmonds and Gordon JJ. Where the primary claim settled is one for damage to reputation or goodwill, the entire settlement is a capital receipt regardless of how damages were

MODULE F: BUSINESS INCOME

When to open: Questions about whether activities constitute a business, losses from those activities, isolated transactions (land development, profit-making schemes), government subsidies, or payments for restricting business activities.

F1: Is There a Business?

What to look for: No single factor is decisive. Work through all indicia and assess the overall picture. The key question is whether the activities, taken as a whole, look like a commercial enterprise or a hobby.

Indicia	Points TO business	Points AGAINST business
Profit motive	Present, genuine	Absent, incidental
Repetition	Regular, systematic	Ad hoc, occasional
Organisation	Records kept, businesslike	No system, no records
Commercial sales	To public at market prices	To family/friends, below cost
Scale	Significant	Tiny
Business plan	Exists	None
Knowledge/skill	Relevant expertise	Lacks knowledge

COPY-PASTE: F1 Business or Hobby

The question is whether [INSERT: taxpayer]'s [INSERT: activities] constitute the carrying on of a business within s 995-1(1) ITAA 1997. The determination is one of fact, impression, and degree, assessed by the "large or general impression gained" from all the relevant indicia: *Martin v FCT* (1953) 90 CLR 470 at 474; *Ferguson v FCT* (1979) 9 ATR 873 per Bowen CJ and Franki J at 311.

Applying the indicia: [INSERT: work through each relevant indicia. Note whether it points to or against a business and why.]

[**Profit motive**: [INSERT: taxpayer] [did / did not] carry on the activity with a profit-making purpose. [Describe evidence.]] [**Repetition**: The activities were [regular and systematic / ad hoc and occasional]. [Describe.]] [**Organisation**: [INSERT: taxpayer] [kept records / subscribed to industry publications / used a businesslike system / had no system and kept no records]. [Describe.]] [**Commercial sales**: [INSERT: taxpayer] [sold produce / services to the public at commercial prices / sold only to family and friends / sold surplus output occasionally]. [Describe.]] [**Scale**: The operation involved [significant / minimal] capital and activity. [Describe.]]

Overall: The majority of indicia [point to / point against] a business. [INSERT: taxpayer] [is / is not] carrying on a business. [If business: Receipts from the activities are ordinary income under s 6-5(1) ITAA 1997 as gains arising from carrying on a business: Parsons' Proposition 14. Expenses are deductible under the second positive limb of s 8-1(1)(b) ITAA 1997.] [If not business: [INSERT: taxpayer]'s activities are a hobby or pastime. Receipts are not ordinary income. Expenses are not deductible under s 8-1.]

COPY-PASTE: F1 - Gambling (Martin principle)

The element of chance in gambling almost invariably militates against a business finding for individual punters. The pursuit of a pastime, however vigorous, does not usually amount to carrying on a business: *Martin v FCT* (1953) 90 CLR 470 at 479. In *Martin*, a hotelier who placed 602 bets over three income years at one racecourse, used a betting system, kept records, and made net profits was still not in business. Gambling activities by [INSERT: taxpayer] [describe the activities]. On the overall picture, [INSERT: taxpayer] [is / is not] carrying on a business of gambling. [If not: Under s 118-37(1)(c) ITAA 1997, any capital gain from gambling is also disregarded. [INSERT: gambling receipts] are not assessable.]

MODULE G: POLICY QUESTIONS

When to open: "Is this a tax?", "Is this progressive?", "Is this an income tax?", MCQ conceptual questions.

G1: Is It a Tax?

What to look for:

- Four elements from Matthews v Chicory Marketing Board. Check each one.
- Is it compulsory? Does the person have a choice?
- Who imposes it? Public authority?
- What is it for? Public purposes?
- Is it enforceable by law? Or a fee for specific services rendered?

COPY-PASTE: G1 - Is it a tax?

A tax is "a compulsory extraction of money by a public authority for public purposes, enforceable by law, and is not a payment for services rendered": Latham CJ in *Matthews v Chicory Marketing Board (Vic)* (1938) 60 CLR 263 at 276. Four elements must all be satisfied.

[INSERT: levy / charge] is assessed against each element:

1. **Element 1 (compulsory):** [INSERT: levy] [is / is not] compulsory because [INSERT: reason, eg the person has no choice but to pay / the person can choose not to engage in the taxed activity].
2. **Element 2 (by a public authority):** [INSERT: levy] is imposed by [INSERT: body]. [This body [is / is not] a public authority because INSERT reason.]
3. **Element 3 (for public purposes):** [INSERT: levy] is used for [INSERT: describe purpose]. [This [is / is not] a public purpose because INSERT reason.]
4. **Element 4 (enforceable by law, not a fee for services):** [INSERT: levy] [is enforceable by law / is a voluntary contribution]. [It [is / is not] a fee for specific services rendered to the payer because INSERT reason.]

[INSERT: levy] [satisfies / does not satisfy] all four elements. [INSERT: levy] [is / is not] a tax.

Supporting authorities for the tax definition:
***Roy Morgan Research Centre Pty Ltd v Commissioner of Taxation* [2011] HCA 35:** the superannuation guarantee charge imposed on employers who failed to make sufficient superannuation contributions for their employees was held to be a tax. The charge was compulsory, imposed by statute, collected for public purposes (the superannuation system), and was not a payment for services rendered to the payer. The fact that a charge may also have a regulatory purpose does not prevent it from being a tax.

***MacCormick v FCT* (1984) 158 CLR 622:** "genuine taxation" within s 51(ii) of the Constitution (the taxing power) is not an "acquisition of property" requiring just terms under s 51(xxxi). A tax is genuine if it is a compulsory exaction imposed by reference to ascertainable criteria with sufficiently general application, used for government or public purposes, and is not arbitrary. This case confirms that the income tax is constitutional as a tax, not an acquisition.

Apply in an exam if challenged on whether a levy is a tax: if the levy raises revenue for general public purposes (not tied to a specific service to the payer) and is enforceable by law against all who fall within the defined criteria, it is a tax within *Matthews*, confirmed by *Roy Morgan*. If it is closely tied to a specific benefit rendered to the payer, it may be a fee or charge rather than a tax.

G2: Is It an Income Tax?

What to look for:

- Income tax: levied on gains derived over a period (assessable income – deductions).
- Wealth tax: levied on a snapshot of total accumulated assets. No measure of gains during a period.
- Consumption tax: levied on spending.

MODULE H: DEDUCTIONS (s 8-1)

When to open: a loss or outgoing has been incurred and the question is whether it is deductible. Runs after assessable income is settled. Work the master sequence, then drop into the relevant sub-module (H1–H7).

MASTER SEQUENCE: DEDUCTION PROBLEM

STAGE 1: Identify the outgoing, the taxpayer, the gateway

- What is the loss or outgoing? Who incurred it, in what capacity (employee / investor / business)?
- General deduction (s 8-1) or specific deduction (s 8-5)? If two provisions cover the same amount, deduct only under the most appropriate: s 8-10.

STAGE 2: Positive limbs s 8-1(1) (→ H1)

- First limb s 8-1(1)(a): incurred **in** gaining or producing assessable income (employees, investors, business).
- Second limb s 8-1(1)(b): **necessarily incurred in carrying on a business** for that purpose (business only).
- Connection is "in the course of," not merely "for the purpose of" or "to enable."

STAGE 3: Temporal nexus (→ H2) — too soon (*Steele*; *Maddalena*/*Spriggs*) or too late (*de Bavay's* vs *AGC*/*Placer Pacific*).

STAGE 4: Apportionment (→ H3) — dual purpose, "to the extent": *Ronpibon Tin*.

STAGE 5: Negative limbs s 8-1(2). One breach defeats the deduction to that extent.

- (a) capital → **H6**
- (b) private or domestic → **H5**
- (c) re exempt income or NANE
- (d) a provision prevents it (s 26-5 fines; s 32-5 entertainment; s 26-30 relative's travel; s 26-19 rebatable benefit) → **H4**

STAGE 6: If capital and denied, find cost recovery (→ H7) — Div 40 / Div 43 / CGT cost base / s 40-880.

STAGE 7: Conclude per outgoing — deductible or not, amount, income year, recovery mechanism if capital.

H1: POSITIVE LIMBS AND NEXUS (s 8-1(1))

What to look for:

- Employee/investor (first limb only) or business (both limbs)?
- Incurred **in the course of** earning income, or merely to put the taxpayer in a position to earn it (the latter fails, carries to H5)?
- The five nexus categories: (1) tax payments, (2) quasi-personal expenses (H4), (3) theft/misappropriation, (4) temporal (H2), (5) dual-purpose (H3).

How to use H1: mixed. First paste the limb block that fits (first limb, second limb, or fails). Then add the Taxes, Negative gearing or s 51AAA blocks only if those facts arise.

Trigger-tag headings: "First positive limb *(employee/investor/business)*"; "Second positive limb *(business only)*"; "Taxes *(only if income tax / GST / other tax in issue)*"; "Negative gearing *(only if net activity loss vs other income)*"; "s 51AAA *(only if expense relates solely to a capital gain)*".

Key formulations: "incidental and relevant"; "the occasion of the loss or outgoing should be found in whatever is productive of the assessable income": *Ronpibon Tin NL v FCT* (1949) 78 CLR 47. "Necessarily incurred" = "appropriate and adapted for the ends of the business," not unavoidable: *Snowden and Willson*; *Magna Alloys*. Business judgment rule: the operator judges what is necessary: *Magna Alloys*. The limbs usually align for business; (1)(b) "adds little" to (1)(a): *Spriggs v FCT; Riddell v FCT* [2009] HCA 22.

Situation	Authority	Result
Interest before income-earning begins	*Steele*	Deductible if held the objective of income + continuing efforts; contemporaneity not essential
Employee travels to obtain a contract	*Maddalena*	"Point too soon"; not deductible
Athlete: playing + commercial income; management fees	*Spriggs; Riddell*	Deductible; streams inextricably linked; distinguishes *Maddalena*
Business entirely ceased, income now different	*de Bavay's*	Not deductible; connection severed
Business continued in substance after a break	*AGC*	Deductible; "assessable income" read generally
Long-tail liability crystallises after sale	*Placer Pacific*	Deductible; occasion in prior operations

COPY-PASTE: H2 – Pre-commencement interest (Steele)

[INSERT: interest], though incurred before [INSERT: taxpayer] derived relevant assessable income, may still be deductible: contemporaneity between outgoing and income is not legally essential: *Steele v DFC of T* (1999) 41 ATR 139. It is deductible where the taxpayer holds the objective of deriving income and makes continuing efforts to that end, provided it is not "too soon," not merely preliminary, not private, and the period is not so long the connection is lost (TR 2004/4). Here, [INSERT: taxpayer]'s commitment to [INSERT: an income-producing use, eg developing a motel / leasing the premises] was [clear / unclear] and [no / a] private use was contemplated. [Vacant land caveat: s 26-102 ITAA 1997 (from 1 July 2019) denies deductions for holding vacant land not used or available for use in carrying on a business, subject to ss 26-102(5)–(8); this may override *Steele* here.]

COPY-PASTE: H2 – Cost of obtaining the income source (Maddalena / Spriggs)

[INSERT: outgoing] was incurred to obtain [INSERT: an employment / a playing contract]. An employee's expense to obtain an employment contract is incurred "at a point too soon" to be incurred in gaining assessable income: *FCT v Maddalena* (1971) 2 ATR 541. [If commercial exploitation: where the taxpayer carries on the business of commercially exploiting their sporting prowess and celebrity, with playing and non-playing income streams that are inextricably linked, fees to negotiate the contracts are deductible under s 8-1(1)(a): *Spriggs v FCT; Riddell v FCT* [2009] HCA 22, distinguishing *Maddalena*.] Here, [INSERT: apply].

COPY-PASTE: H2 – Post-cessation (de Bavay's / AGC / Placer Pacific)

[INSERT: outgoing] was incurred after [INSERT: taxpayer]'s business had [ceased / been suspended]. Where a business has entirely ceased and the year's income derives from entirely different activities, related outgoings are "completely dissociated from the gaining or production of the assessable income of that year" and not deductible: *Amalgamated Zinc (de Bavay's) Ltd v FCT* (1935) 54 CLR 295. But provided the occasion of the outgoing is found in business operations directed to assessable income generally, the fact it was incurred later and the active business has ceased does not determine deductibility: *AGC (Advances) Ltd v FCT* (1975) 132 CLR 175 per Mason J; *Placer Pacific Management Pty Ltd v FCT* (1995) 31 ATR 253. "Assessable income" is read generally, not year-by-year: *AGC*. Here, [INSERT: the business had / had not continued in substance; the liability did / did not have its occasion in prior operations]. [Deductible / not deductible].

H3: APPORTIONMENT (dual purpose)

How to use H3: single block, situational. Use only if one outlay serves both an income and a non-income purpose.

COPY-PASTE: H3 – Apportionment (Ronpibon Tin)

[INSERT: outgoing] was incurred for dual purposes: [INSERT: income-producing] and [INSERT: other, eg private use / deriving exempt income]. The words "to the extent" in s 8-1 permit apportionment: *Ronpibon Tin NL v FCT* (1949) 78 CLR 47. [If divisible: distinct severable parts are used for income and other purposes; divide by actual application.] [If

The question is whether [INSERT: outgoing] is on revenue or capital account under s 8-1(2)(a) ITAA 1997. The distinction "corresponds with the distinction between the business entity, structure, or organization set up... for the earning of profit and the process by which such an organization operates": *Sun Newspapers Ltd v FCT* (1938) 61 CLR 337 at 359 per Dixon J. The governing question is what the outgoing is "calculated to effect from a practical and business point of view": *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634; *FCT v Sharpcan Pty Ltd* (2019) 269 CLR 370 at [18]. Three matters are weighed (*Sun Newspapers* at 363): (a) the character of the advantage sought; (b) the manner of its use or enjoyment; and (c) the means adopted to obtain it.

COPY-PASTE: H6 – Apply to capital

Applying the three matters: (a) the advantage sought was [INSERT: enduring/structural, eg freedom from competition / a gaming entitlement / an exclusive licence], fortifying the profit-yielding subject; (b) relied upon as a structural foundation, not deployed in the continuous struggle for trade; (c) secured by a [INSERT: once-and-for-all / instalment] payment for future enjoyment. Neither recurrence nor duration is determinative; a short-term advantage can still be capital: *Sun Newspapers* at 361–362. Capital, not deductible under s 8-1. [Go to H7.]

COPY-PASTE: H6 – Apply to revenue

Applying the three matters: (a) the advantage was temporary and consumable in trading; (b) used in the continuous and recurrent struggle for trade, merging into the ordinary process of earning income; (c) obtained by a periodical outlay commensurate with the period of enjoyment. Revenue, deductible in full under s 8-1.

Case bank (deploy the closest analogue)

COPY-PASTE: H6 – Eliminating competition / preserving structure (Sun Newspapers, Broken Hill Theatres)

A payment to eliminate competition or preserve the business structure from competitive impairment is capital, even if temporary and even if no tangible asset is acquired: *Sun Newspapers Ltd v FCT* (1938) 61 CLR 337 at 364–365 (once-and-for-all payment to remove a rival; goodwill is a capital asset, 355–356). Legal costs to oppose a competitor's licence application are likewise capital, going to preserving the profit-yielding subject, even if the benefit lasts only a year and similar costs recur: *Broken Hill Theatres Pty Ltd v FCT* (1952) 85 CLR 423 (apparent recurrence is not true recurrence where each occasion is isolated). Here, [INSERT: apply]. Capital.

COPY-PASTE: H6 – Preserving an existing right without a new asset (Hallstroms)

[Note the tension.] In *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634, the majority held legal costs to oppose renewal of a competitor's patent were revenue, merely maintaining the taxpayer's existing right to use a process without acquiring a new enduring benefit; Dixon J dissented (the expenditure went to the structure of the business, capital). Dixon J's structure/process approach was later vindicated and is now dominant. Character "depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights." Here, [INSERT: whether the outgoing merely preserves an existing position (arguably revenue) or fortifies the structure (capital)]. [See also *FCT v Consolidated Fertilizers Ltd* (1991): costs defending the validity of ongoing licence agreements were revenue, applying the form test; not every defence of a right is capital.]

COPY-PASTE: H6 – Payment integral to acquiring a capital asset (AusNet)

Where a payment is part of the consideration for acquiring a capital asset, it is capital even if stated to relate to particular years or paid by instalments: *AusNet Transmission Group Pty Ltd v FCT* [2015] HCA 25. The inquiry is, from the taxpayer's perspective, "what was the character of the advantage sought." The assumption of the charges there was an integral part of the consideration for the transmission licence, an intangible asset forming part of the business structure without which the rest of the assets were pointless (distinguishing *Cliffs International Inc v FCT* (1979) 142 CLR 140, where payments were contingent). Here, [INSERT: the outgoing was integral to acquiring INSERT: asset]. Capital.

COPY-PASTE: H6 – Periodic payments in the struggle for trade (BP Australia vs Strick)

Mechanism	When it applies	Limitation
CGT cost base (ss 110-25, 110-35)	CGT assets; recovered on a CGT event	Wasting intangibles yield only a capital loss on expiry, possibly far off (*Star City*: 99-year lease); some defensive costs create no CGT asset (*Hallstroms*, *Broken Hill Theatres*)
s 40-880 (black hole)	Last resort; business capital expenditure not otherwise taken into account	Strict conditions; goodwill exception narrow

Priority and exclusivity: the first three mechanisms each switch off s 40-880, a depreciating asset by (5)(a), land by (5)(c), a lease or other legal or equitable right by (5)(d), and any amount that could be taken into account in working out a capital gain or loss by (5)(f). So you never run CGT cost base and s 40-880 on the same amount: where the cost sits in a CGT cost base, the black hole is shut out. This defeated the s 40-880 fallback in *FCT v Sharpcan Pty Ltd* (2019) 269 CLR 370, where the cost of a structural right formed part of the cost base of a CGT asset. The one place this bends is the narrow goodwill exception in s 40-880(6), below.

COPY-PASTE: H7 – CGT cost base recovery

Although not deductible under s 8-1, the cost of [INSERT: outgoing] may be recovered through the CGT cost base. [If acquisition: first element, s 110-25(2).] [If value-preserving: fourth element, s 110-25(5), expenditure to increase or preserve the value of the asset.] [If title: fifth element, s 110-25(6), expenditure to establish, preserve or defend title over a CGT asset, eg legal costs in *John Fairfax*-type litigation.] Recovery occurs on a CGT event (eg event A1 on disposal, or C2 on expiry or termination of an intangible) by deducting the cost base from capital proceeds. The black hole provision does not apply, the amount being excluded from s 40-880 by s 40-880(5)(f). [Limitation: a wasting intangible yields only a capital loss on expiry, potentially years later; a defensive outgoing as in *Hallstroms* or *Broken Hill Theatres* may create no CGT asset under s 108-5 at all.]

COPY-PASTE: H7 – Black hole expenditure (s 40-880)

If no other provision takes [INSERT: outgoing] into account, s 40-880(2) ITAA 1997 allows a deduction in equal proportions over five years for capital expenditure in relation to a business carried on, formerly carried on, or proposed to be carried on for a taxable purpose, provided none of the s 40-880(5) exclusions apply (notably (a) cost of a depreciating asset, (c) cost of land, (d) a lease or other legal or equitable right, (f) amounts taken into account for CGT). [If proposed business: it must be reasonable to conclude it will be carried on within a reasonable time, s 40-880(7); small business start-up advice or fees may be immediately deductible under s 40-880(2A).] [Goodwill exception, s 40-880(6): the (5)(d) and (5)(f) exclusions do not apply to expenditure to preserve, not enhance, goodwill where the value of the right is solely attributable to its effect on goodwill, though this is narrow and failed in *Sharpcan* on both limbs.] Here, [INSERT: apply].

COPY-PASTE: H7 – Why s 40-880 is unavailable (another mechanism applies)

Section 40-880 cannot be used for the $[INSERT], because it is the provision of last resort and is switched off to the extent the expenditure is otherwise dealt with: s 40-880(5). Here the amount [forms part of the cost of a depreciating asset: (5)(a) / forms part of the cost of land: (5)(c) / is in relation to a lease or other legal or equitable right: (5)(d) / could be taken into account in working out a capital gain or loss: (5)(f)], so recovery is through [INSERT: mechanism], not s 40-880.

H8: REPAIRS (s 25-10)

When to open: expenditure is incurred on an *existing* asset (premises, plant, machinery, tools or articles) and the question is whether it is a deductible repair under s 25-10 or non-deductible capital (an improvement, a reconstruction of an entirety, or an initial repair). This is a specific deduction provision, and where it and s 8-1 both apply to the same amount, s 25-10 is the more appropriate provision and prevails: s 8-10; TR 97/23 [7].

How to use H8: sequential gateway. Confirm income-purpose use and step out s 25-10, then run the four-way sort (repair / improvement / entirety / initial repair). If repair, deduct under s 25-10. If capital, route to H7 for cost recovery.

MODULE I: BUSINESS ASSETS — COST RECOVERY (Trading Stock & Depreciation)

When to open: a business acquires, holds or disposes of an asset and you need to work out how its cost is recovered and how proceeds are taxed. The front-end routes you to the correct regime; do that first.

MASTER SEQUENCE: WHICH COST-RECOVERY REGIME?

For every business asset, ask what it is **held for**, because that fixes the regime (the regimes are mutually exclusive):

The asset is...	Regime	Go to
Held for **sale or exchange in the ordinary course of business** (incl. raw materials, WIP for manufacturers, land held by a developer)	**Trading stock, Div 70**	I1–I5
Used in the business, has a **limited effective life** and **declines in value** (plant, equipment, listed intangibles)	**Depreciation, Div 40**	I6–I11
A **building or structural improvement**	**Capital works, Div 43**	I12
A **non-wasting capital asset** (eg land held to use, not resell)	**CGT cost base**, recovered on disposal	Module D
Consumed at once (eg consumables, spare parts in normal quantities)	**Immediate deduction, s 8-1**	Module H

Anti-overlap anchors: trading stock is carved out of CGT (s 118-25) and Div 40 (s 40-30(1)(b)); depreciating assets used for a taxable purpose are carved out of CGT (s 118-24). So once you pick the regime, the others fall away.

I1: IS IT TRADING STOCK? (s 70-10)

How to use I1: alternative on the threshold (is / is not trading stock), then situational add-ons (land, shares, spare parts) as the facts require.

Trigger-tag: "Land *(St Hubert's Island)*"; "Spare parts / consumables *(Guinea Airways)*".

(Div 70 run (I1→I5) Trading stock write order: I1 (is it stock?) → I2 (three-step + proceeds) → [I3 on hand, if timing in issue] → [I4 valuation, if valuing closing stock] → [I5, if non-arm's length / abnormal disposal / conversion].

What to look for: the defining question is the **purpose for which the item is held on the relevant day**, not once and for all. "Held" is assessed at a point in time.

Rule: trading stock includes anything produced, manufactured or acquired that is **held for purposes of manufacture, sale or exchange in the ordinary course of a business** (s 70-10(1)(a)), and live stock (s 70-10(1)(b)). The definition is inclusive, not exhaustive: *FCT v St Hubert's Island Pty Ltd* (1978) 138 CLR 210. Excluded: a Div 230 financial arrangement (s 70-10(2)(a)) and certain complying-super CGT assets (s 70-10(2)(b)); PDF shares are not trading stock (s 124ZO ITAA 1936).

Consequences: an asset sold only in extraordinary circumstances, or bought to **use and hold** (even if later sold when obsolete), is not trading stock; nor is an asset held by someone whose activities do not amount to a business (eg an investor's home unit).

COPY-PASTE: I1 – Item is trading stock

[INSERT: asset, eg the stock of furniture / the subdivided lots] is trading stock under s 70-10(1)(a) ITAA 1997, being [produced / manufactured / acquired] and held by [INSERT: taxpayer] for [sale / exchange] in the ordinary course of its [INSERT: business, eg retail / land development] business. "Held" is assessed on the relevant day, so status turns on

COPY-PASTE: J-T3 – Timing / disclaimer (*only if allocation timing or a disclaimer is in issue*)

A discretionary allocation must be made **before the end of the income year** to crystallise present entitlement; an attempt to split the income year by the deed is ineffective, and daily apportionment applies only to passive periodic income: *Colonial First State Investments v FCT* [2011] FCA 16. Tax liability is fixed at year end and cannot be altered by a later disclaimer: *FCT v Carter* [2022] HCA 10. [Legal disability is undefined but covers minors, undischarged bankrupts and the mentally incapacitated.]

J-T4: DIVISION 6 ALLOCATION CASCADE (who is taxed)

What to look for: once present entitlement, legal disability and residency are known, route each share to one Division 6 section. Foundation: the trustee is not liable except as the Act provides (s 96).

How to use J-T4: alternative. For each share of net income, paste the one block the cascade points to.

Situation	Taxed	Section	Rate
Presently entitled, no disability, resident	Beneficiary	s 97	Marginal
Presently entitled, under legal disability	Trustee	s 98(1)	Individual (Div 6AA may apply)
Deemed presently entitled (s 95A(2))	Trustee	s 98(2)	Individual
Presently entitled non-resident	Trustee	s 98(2A)/(3)	Individual, or corporate if beneficiary a company
No present entitlement, deceased estate	Trustee	s 99	Individual
No present entitlement, otherwise (eg discretionary failure to allocate)	Trustee	s 99A	45%

COPY-PASTE: J-T4 – Beneficiary taxed directly (s 97)

[INSERT: beneficiary] is presently entitled, under no legal disability and a resident, so is taxed **directly** on their share of the net income under s 97(1) ITAA 1936 (integration). The amount is their proportionate share (J-T5), apportioned for any non-resident period to Australian-source income.

COPY-PASTE: J-T4 – Trustee taxed, legal disability (s 98(1))

[INSERT: beneficiary] is presently entitled but under a legal disability ([INSERT: minority]), so the **trustee** is assessed as proxy on that share at **individual rates** under s 98(1) ITAA 1936. [If a minor: Division 6AA may push the rate to the top marginal rate, J-T8.]

COPY-PASTE: J-T4 – Trustee taxed, deemed entitlement (s 98(2))

[INSERT: beneficiary] is deemed presently entitled under s 95A(2) and is not under a legal disability, so the **trustee** is assessed at **individual rates** under s 98(2) ITAA 1936.

COPY-PASTE: J-T4 – Trustee taxed, non-resident beneficiary (s 98(2A)/(3))

[INSERT: beneficiary] is presently entitled but a non-resident at year end, so the **trustee** is assessed under s 98(2A)/(3) ITAA 1936 on the Australian-source share, at **individual rates** (or the **corporate rate** if the beneficiary is a company: s 98(3)(b)).

COPY-PASTE: J-T4 – Trustee taxed, no present entitlement (s 99 or s 99A)

No beneficiary is presently entitled to [INSERT: this share], so the **trustee** is assessed. [If a deceased estate / bankrupt estate, and the Commissioner does not consider s 99A appropriate (s 99A(2)): s 99 applies at **individual rates**.] [Otherwise, eg a discretionary trust that failed to allocate: s 99A applies at the **special rate of 45%** (Income Tax Rates Act 1986 s 12(9)).]

MODULE M: TAXPAYER PENALTIES

When to open: an assessment has been increased (a shortfall), a false or misleading statement was made, or Part IVA or another scheme provision applied, and you need the administrative penalty. The penalty is **in addition to** the underlying tax and the shortfall interest charge.

Master sequence: is there a shortfall? → which subdivision (M1 statements / M2 schemes)? → mental element → base penalty rate → adjustments → exceptions (statements only) → add shortfall interest charge.

How to use Module M: sequential. Run after the substantive analysis has produced the shortfall or the cancelled benefit.

M1: STATEMENTS (Subdivision 284-B)

What to look for: a false or misleading statement to the Commissioner (s 284-75(1)), a position that is not reasonably arguable (s 284-75(2)), or a failure to lodge a necessary document (s 284-75(3)). The penalty is a percentage of the shortfall, set by the taxpayer's mental element.

How to use M1: sequential. Establish liability, then apply the rate by mental element, then adjustments, then check the exceptions.

COPY-PASTE: M1 – Liability for a statement (s 284-75)

[INSERT: taxpayer] is liable to an administrative penalty because [they made a statement to the Commissioner that is **false or misleading in a material particular**, whether by what it contains or what it omits: s 284-75(1) / they treated an income tax law as applying in a way that was **not reasonably arguable**: s 284-75(2) / they **failed to give a necessary document** by the day required and the Commissioner determined the liability without it: s 284-75(3)]. A statement made by [INSERT: taxpayer]'s agent is treated as made by [INSERT: taxpayer]: s 284-25.

Base penalty where there IS a shortfall (decision aid):

Mental element	Penalty (% of shortfall)
Reasonable care **and** reasonably arguable	0%
Position not reasonably arguable	25%
Failure to take reasonable care (negligence)	25%
Recklessness	50%
Intentional disregard	75%

Base penalty where there is NO shortfall:

Mental element	Penalty
Negligence	20 penalty units
Recklessness	40 penalty units
Intentional disregard	60 penalty units

COPY-PASTE: M1 – Base penalty rate (s 284-90)

The base penalty is a percentage of the **shortfall amount** (the difference between the correct tax and the tax based on the conduct), fixed by [INSERT: taxpayer]'s mental element under s 284-90: **0%** (reasonable care and a reasonably arguable position), **25%** (no reasonable care, or a position not reasonably arguable), **50%** (recklessness), or **75%** (intentional disregard). A position is **reasonably arguable** if it is about as likely to be correct as the contrary view (s 284-15); where it is, the 25% not-reasonably-arguable penalty under s 284-75(2) is avoided. [If there is no shortfall, fixed penalty units apply: 20 (negligence), 40 (recklessness), 60 (intentional disregard).] Here, [INSERT: classify the mental element and state the rate].

MODULE O: GOODS AND SERVICES TAX

When to open: the question involves a supply or acquisition by a GST-registered (or registrable) entity, an importation, or the GST/income-tax interaction.

Master sequence: O1 (is the entity registered or required to be registered?) → O2 (is there a taxable supply? if so, GST at 10% of value) → O3 (is there a creditable acquisition? if so, an input tax credit) → O4 (is the supply GST-free or input taxed?) → O5 (BAS, attribution, tax invoices) → O6 (importations / offshore supplies) → O7 (interaction with income tax and FBT).

O.0: FRAMEWORK (reference)

Nature. GST is a **consumption tax** (not income or wealth), levied at **10% of the value** of a taxable supply, regardless of whether the supplier or consumer is profitable. It is a **value-added tax**: imposed at each level of the supply chain on the value added at that stage, with the input tax credit (ITC) mechanism zeroing out the intermediaries so the economic burden falls on the **final private consumer**. It is administered federally by the ATO, but the revenue goes to the States and Territories. Because it is regressive as a proportion of income, basic necessities are made GST-free.

Statutory framework. Because the Constitution requires a taxation law to deal with one subject of taxation, GST sits in separate legislation: A New Tax System (Goods and Services Tax) Act 1999 (the **GST Act**); A New Tax System (Goods and Services Tax Administration) Act 1999; and separate Imposition Acts (General, Customs, Excise).

Chain mechanism. On a table sold manufacturer → wholesaler ($110) → retailer ($220) → consumer ($330), each business remits the GST it collects less the ITC on its inputs ($10 net at each stage), so the total $30 GST is borne entirely by the final consumer; the intermediaries net out.

COPY-PASTE: O.0 – Income-tax integration (s 17-5, s 27-5, s 27-80)

GST collected from a customer on a taxable supply is **non-assessable non-exempt income**, so [INSERT: taxpayer] returns only the **GST-exclusive** amount as income: s 17-5 ITAA 1997. Where an ITC is available on an expense, the deductible amount is likewise the **GST-exclusive** amount, the ITC component being denied as a deduction: s 27-5 ITAA 1997 (so where there is **no** ITC entitlement, eg an input-taxed supply, the full GST-inclusive amount is deductible). The cost of a depreciating asset is reduced by the amount of any ITC, so [INSERT: taxpayer] depreciates only the GST-exclusive cost: s 27-80 ITAA 1997. [Worked: $220,000 incl GST income → $200,000 assessable; $110,000 incl GST expenses → $100,000 deductible.]

O1: IS THE ENTITY REGISTERED OR REQUIRED TO BE REGISTERED?

What to look for: registration is the **gateway** to the system: once registered (or required to be), the entity must charge GST on taxable supplies and may claim ITCs on creditable acquisitions. Registration needs, as a threshold, that the entity is **carrying on an enterprise**; it is then compulsory above the turnover threshold and otherwise optional.

Write order: enterprise? → compulsory (turnover threshold) → or optional → special rule (taxi/ride-sourcing).

How to use O1: sequential. Always establish the enterprise first; then compulsory or optional.

COPY-PASTE: O1 – Carrying on an enterprise (s 9-20)

[INSERT: entity] is carrying on an **enterprise**: an activity or series of activities done **in the form of a business** (s 9-20(1)(a)), or **in the form of an adventure or concern in the nature of trade** (s 9-20(1)(b)), or on a regular or continuous basis as a **lease, licence or grant of an interest in property** (s 9-20(1)(c)), or by a charity, DGR fund or government body (s 9-20(1)(d)–(h)). The income-tax "business" indicia carry over (if it is a business for income tax, it is an enterprise), but the enterprise concept is **broader**, also catching isolated commercial transactions (an adventure in the nature of trade, eg *FCT v Whitfords Beach Pty Ltd*) and property leasing. Enterprise does **not** include activities done as an **employee** or for withholding payments (s 9-20(2)(a)), a **private recreational pursuit or hobby** (s 9-

[INSERT: entity] acquires the thing for a **creditable purpose** to the extent it does so in **carrying on its enterprise** (s 11-15(1)). It is **not** for a creditable purpose to the extent the acquisition **relates to making input taxed supplies** (s 11-15(2)(a)) or is of a **private or domestic nature** (s 11-15(2)(b)). The input-taxed carve-out operates by reference to the **relationship between the acquisition and the input taxed supply**, not the entity's overall enterprise, so an acquisition related to input taxed supplies is not creditable even though made within a broader taxable enterprise: *Rio Tinto Services Pty Ltd v FCT* [2015] FCAFC 117 (ITCs on residential accommodation supplied to a mining workforce denied). Acquisitions relating to the provision of **fringe benefits** are treated as for a creditable purpose despite the private element to the employee (GSTR 2001/3). Here, [INSERT: apply, eg the plumbing repairs relate to making input taxed residential rent and are not creditable].

COPY-PASTE: O3 – Financial acquisitions threshold (*only if the entity makes financial supplies*)

Although acquisitions relating to **financial supplies** are normally not creditable, they are treated as creditable if [INSERT: entity] does **not exceed the financial acquisitions threshold**: s 11-15(4). The threshold is not exceeded where **both** the ITCs on financial-supply-related acquisitions do not exceed **$150,000** (ss 189-5, 189-10) **and** they are **less than 10%** of total ITCs. [If the threshold is exceeded, a 75% **reduced input tax credit** may still be available on certain acquisitions: s 70-5.] Here, [INSERT: apply both limbs].

COPY-PASTE: O3 – Partly creditable / apportionment (s 11-30)

The acquisition is for a creditable purpose only **to the extent** it is used in the enterprise, so the ITC is reduced to that extent (s 11-30). Here, the acquisition is [INSERT: %] business, so the ITC is $[INSERT GST] × [%] = $[INSERT]. [Worked: $22 polish, 80% business → ITC = $2 × 80% = $1.60.]

COPY-PASTE: O3 – Supply to you was a taxable supply

The supply to [INSERT: entity] was a **taxable supply** from the supplier's perspective: running s 9-5 from the supplier's side *(→ O2)*, [INSERT: supplier] made a supply for consideration, in the course of its enterprise, connected with Australia, and was registered or required to be. Where the price is stated to include GST, this element is satisfied by inference.

COPY-PASTE: O3 – Entitlement and amount (s 11-20, s 11-25)

[INSERT: entity] is entitled to the input tax credit (s 11-20), equal to the **GST payable on the supply** acquired (s 11-25), reduced if the acquisition is only partly creditable. Here, the GST embedded in the $[INSERT] price is price ÷ 11 = $[INSERT], so the ITC is $[INSERT].

COPY-PASTE: O3 – Non-deductible expenses (Division 69) (*only if a non-deductible category is involved*)

Even if all the s 11-5 elements are met, the acquisition is **not creditable** if it is a **non-deductible expense** for income tax of a kind caught by Division 69: penalties (s 26-5), a relative's travel (s 26-30), family maintenance (s 26-40), recreational clubs (s 26-45), leisure facilities or boats (s 26-50), **entertainment** (Div 32), non-compulsory uniforms (Div 34), or non-deductible non-cash business benefits (s 51AK ITAA 1936): s 69-5. The rule does **not** apply where the expense is deductible because it relates to a **fringe benefit**. [Car limit: the ITC on a car is capped at **1/11 of the car limit** ($69,674 for 2025–26, so a maximum ITC of about $6,334): s 69-10.] [Worked: meal entertainment with a 50/50 election → ITC only on the deductible half.]

O4: IS THE SUPPLY GST-FREE OR INPUT TAXED?

What to look for: three categories under s 9-30: **taxable** (10% GST, ITCs retained), **GST-free** (Division 38: no GST, **ITCs retained**), and **input taxed** (Division 40: no GST, **no ITCs**). The ITC consequence is the key practical difference.

How to use O4: alternative. Identify the category; if the supply has more than one part, classify it as mixed or composite.

COPY-PASTE: O4 – Input taxed consequences

No GST is charged, **and** [INSERT: supplier] is **not** entitled to ITCs on related acquisitions (s 11-15(2)(a)). [Other input taxed categories: precious metals after the first refined supply; school tuckshops (Subdiv 40-E) and charity fund-raising events (Subdiv 40-F), each **by election**.]

COPY-PASTE: O4 – Mixed vs composite supply (s 9-80) (*Luxottica*)

The supply has more than one part. A **mixed supply** can be unbundled into separately identifiable parts, each treated on its own footing with the value **apportioned** under s 9-80 by a reasonable method; a **composite supply** has a dominant part with the rest **integral, ancillary or incidental**, and takes the character of the dominant part as a single supply. In a mixed supply the taxpayer may **discount the taxable component alone** (*FCT v Luxottica Retail Australia Pty Ltd* [2011] FCAFC 20, discount on taxable frames bundled with GST-free lenses need not be apportioned). Here, [INSERT: eg property 70% commercial/taxable and 30% residential/input taxed → apportion the $200,000 price; GST = 10% × (10/11 × $140,000) = $12,727].

Supply summary (decision aid):

Supply type	GST charged?	ITCs on related acquisitions?
Taxable	Yes (10%)	Yes
GST-free	No	Yes
Input taxed	No	No

O5: BAS, ATTRIBUTION AND THE NET AMOUNT

What to look for: how and when GST and ITCs are reported, the net amount for the period, the cash-vs-accruals basis, and the tax-invoice requirement for claiming ITCs.

Write order: reporting frequency → net amount → cash vs accruals → attribution timing → tax invoice → adjustments → four-year limit.

How to use O5: sequential/situational.

COPY-PASTE: O5 – Net amount and reporting frequency (s 17-5)

[INSERT: entity] reports GST on its **Business Activity Statement**. The **net amount** for the period is GST payable on taxable supplies less ITCs on creditable acquisitions (plus or minus adjustments): s 17-5(1) GST Act, leaving the entity in a net payable or net refundable position. Reporting is **quarterly** by default; **monthly** is compulsory where annual turnover exceeds **$20 million**, the entity will carry on business for less than 3 months, or it has a poor compliance history (s 27-15), and any entity may **elect** monthly reporting (s 27-10). [Anti-avoidance for GST is in Div 165, analogous to Part IVA.]

COPY-PASTE: O5 – Cash vs accruals (s 29-40)

The default basis is **accruals** (non-cash): GST and ITCs are attributed to the earlier of when consideration is received/provided or an invoice is issued. [INSERT: entity] may instead choose the **cash basis** (s 29-40) if it is a **small business entity** (aggregated turnover under $10 million), does not carry on a business and has GST turnover at or below the **$2 million** cash accounting turnover threshold, or accounts for income tax on a receipts basis. On the cash basis, GST and ITCs are attributed only as consideration is actually received or provided.

COPY-PASTE: O5 – Attribution (Division 29)

GST on a taxable supply is attributed to the tax period in which **consideration is received**, or, if earlier, an **invoice is issued** (s 29-5(1)); on the cash basis, only to the extent consideration is received (s 29-5(2)). The ITC on a creditable acquisition is attributed to the period in which **consideration is provided**, or, if earlier, an invoice is issued (s 29-10(1)); on the cash basis, only as consideration is provided (s 29-10(2)). Critically, the ITC is **not attributable until**