

12 Taxation & Revenue Law Cases and Statutes

1. GENERAL PRINCIPLES	2
(1) LEGISLATIVE FRAMEWORK	2
(2) CONCEPT OF INCOME	3
(3) RESIDENCE	4
(4) SOURCE	6
(5) DERIVATION	8
(6) EXEMPT INCOME	10
2. INCOME FROM PERSONAL SERVICES	10
(1) INCOME ACCORDING TO ORDINARY CONCEPTS	10
(2) RESTRICTIVE COVENANTS	11
(3) RELEVANT STATUTORY PROVISIONS	11
(4) FRINGE BENEFITS TAX ASSESSMENT ACT 1986	12
3. INCOME FROM PROPERTY	13
(1) ANNUITIES	13
(2) ROYALTIES	15
(3) INTEREST	16
(4) LEASE AND RENTAL INCOME	17
4. INCOME FROM A BUSINESS	18
(1) CONCEPT OF A BUSINESS	18
(2) TAXATION OF BUSINESS INCOME	18
(3) TRADING STOCK	22
(4) COMPENSATION	23
5. CAPITAL GAINS TAX	25
(1) STRUCTURE OF INCOME TAX ASSESSMENT ACT 1997	25
(2) CGT EVENTS	26
(3) MEANING OF CGT ASSETS	26
(4) COST BASE	26
(5) CAPITAL PROCEEDS	26
(6) CALCULATION OF CAPITAL GAIN/LOSS	27
(7) EXEMPTIONS	27
(8) SPECIFIC TOPICS	27
6. ALLOWABLE DEDUCTIONS	27
(1) GENERAL DEDUCTIONS	27
(2) REPAIRS	32
(3) CAPITAL ALLOWANCES	33
(4) BAD DEBTS	33
(5) LOSSES	34
7. TAXATION OF COMPANIES AND SHAREHOLDERS	34
(1) DEFINITION OF "DIVIDEND"	34
(2) TAXATION OF SHAREHOLDERS	34
(3) DEEMED DIVIDENDS	34
(4) OPERATION OF IMPUTATION	35
8. PARTNERSHIPS	35
(1) DEFINITION OF "PARTNERSHIP"	35
(2) TAXATION OF PARTNERSHIP INCOME	36

(3) APPLICATION OF CAPITAL GAINS TAX TO PARTNERSHIPS.....	36
9. TRUSTS AND THE TAXATION OF CHILDREN	36
(1) CONCEPT OF A TRUST	36
(2) TAXATION OF TRUST INCOME	36
(3) REVOCABLE TRUSTS AND TRUSTS FOR MINORS	37
(4) TAXATION OF INCOME OF CHILDREN	38
10. GOODS AND SERVICES TAX	38
(1) TAXABLE SUPPLIES.....	38
(2) GST-FREE SUPPLY	38
(3) INPUT TAXED SUPPLY	39
(4) CREDITABLE ACQUISITION	39
(5) IMPORTATIONS.....	39
(6) ADMINISTRATION & INTERACTION WITH INCOME TAX.....	39
11. RETURNS, ASSESSMENTS, OBJECTIONS AND APPEALS	40
(1) OBLIGATION TO LODGE INCOME TAX RETURN AND GST RETURN	40
(2) ASSESSMENT/AMENDED ASSESSMENT.....	40
(4) OBJECTIONS	40
12. COLLECTION AND RECOVERY	41
(1) POWERS OF THE COMMISSIONER.....	41
(2) RECOVERY OF UNPAID TAX.....	41
(3) INCOME TAX - PAY-AS-YOU-GO (PAYG).....	42
13. GENERAL ANTI-AVOIDANCE PROVISIONS AND ETHICS	42
(1) FORM VERSUS SUBSTANCE IN INTERPRETING LEGISLATION	42
(2) INCOME TAX ASSESSMENT ACT 1936, PT IVA	42
(3) ETHICS	43

1. General Principles

(1) Legislative framework

Legislative Framework: Income Tax Assessment Act 1997, Chapter 1

- **Core Purpose:** Chapter 1 sets out the core obligations and fundamental parameters of the Australian income tax system, including who must pay tax and how it is calculated. [1, 2]
- **Key Components:** It establishes the central calculation formula where a taxpayer's taxable income is determined by subtracting allowable deductions from their total assessable income. [1]

(a) Constitutional Aspects of Taxation

- **Commonwealth Power:** Section 51(ii) of the Australian Constitution grants the Federal Parliament the power to make laws with respect to taxation, provided they do not discriminate between States. [1]

- **Separation of Laws:** Section 55 requires that laws imposing taxation must deal only with the imposition of tax, preventing the government from hiding controversial non-tax clauses inside revenue bills. [1, 2, 3, 4]

(b) Structure of the ITAA 1997 and Relationship to the ITAA 1936

- **Dual Operation:** The ITAA 1997 was created to rewrite the complex ITAA 1936 into plain English, but the rewrite was never fully completed. [1, 2, 3, 4]
- **Coexistence:** Both Acts currently operate concurrently as a single, combined legislative framework, meaning taxpayers must reference sections from both books to resolve a single tax issue. [1, 2]

(c) Direct Versus Indirect Taxation

- **Direct Taxation:** Direct taxes, such as personal and corporate income tax, are levied straight from the earner's income or wealth, meaning the economic burden cannot be easily shifted. [1, 2, 3]
- **Indirect Taxation:** Indirect taxes, like the Goods and Services Tax (GST), are imposed on goods and services at the point of sale and are ultimately paid by the consumer. [1, 2, 3]

(2) Concept of income

Income Tax Assessment Act 1997, Division 6

- **Assessable Income Split:** Division 6 outlines that a taxpayer's assessable income consists of ordinary income and statutory income, while excluding exempt and non-assessable non-exempt income. [1, 2]
- **Core Mechanisms:** It directs taxpayers to Section 6-5 for ordinary income (income according to ordinary concepts) and Section 6-10 for statutory income (amounts included via specific legislative provisions). [1, 2]

Income Tax Assessment Act 1936, ss 6, 21

- **Section 6 (Definitions):** Section 6 acts as the broad dictionary for the Act, defining critical terms such as "income from personal exertion" and "year of income" to clarify statutory boundaries. [1, 2]
- **Section 21 (Non-Cash Consideration):** This section dictates that where consideration for a transaction is paid in a non-cash format, its value must be converted into a monetary equivalent for tax calculations. [1, 2]

(a) Common Law Concept of Income

- **Judicial Determination:** Because the legislation does not explicitly define ordinary income, the courts must characterise gains based on judicial precedents and ordinary usage. [1, 2]

- **Key Indicators:** Common law establishes that ordinary income typically features regularity, recurrence, and a sufficient nexus (connection) to an earning activity like employment or business. [1, 2]

(b) Receipt of Money or Money's Worth

- **Convertibility Rule:** For a receipt to be classified as ordinary income, it must either be cash or something that can be converted into money. [1, 2]
- **Exclusion of Financial Savings:** The law holds that saving an expenditure does not equate to income, as income constitutes what "comes in," rather than what is saved from going out. [1]

Tennant v Smith [1892] AC 150

- **Free Accommodation Case:** A bank manager was provided free living quarters at his workplace but was legally forbidden from subletting the premises for profit.
- **The Precedent:** The House of Lords ruled that the accommodation was not ordinary income because it could not be converted into money or money's worth. [1, 2]

FCT v Cooke and Sherden (1980) 80 ATC 4140

- **Free Holiday Scheme:** Soft drink retailers received free overseas holiday packages from a manufacturer as a sales incentive, but the trips were strictly non-transferable and could not be sold.
- **The Precedent:** The Full Federal Court ruled the holidays were not ordinary income because they could not be converted into money, reinforcing the principle that a financial benefit is not taxable if it lacks cash convertibility

(3) Residence

Income Tax Assessment Act 1997, s 995-1 & Income Tax Assessment Act 1936, s 6(1)

- **Legislative Definitions:** Section 995-1 of the ITAA 1997 points directly to Section 6(1) of the ITAA 1936 for the primary definitions of an Australian resident.
- **Taxation Consequences:** These sections dictate whether a taxpayer is taxed on their worldwide income (residents) or solely on income derived from Australian sources (non-residents).

(aa) Ordinary Meaning of "Resident"

- **Resides Test:** This common law test evaluates whether a person physically resides in Australia based on their habits, history, and life arrangements.
- **Fact and Degree:** Determining residency under the ordinary meaning is a question of fact rather than a strict legal formula.

IRC v Lysaght [1936] AC 234

- **Regular Business Trips:** A taxpayer stepped down as director but continued visiting the UK for one week monthly for meetings, staying in hotels.

- **The Precedent:** The House of Lords held that regularity and purpose of visits can establish residency, even without a permanent home.

Gregory v DFCT (1937) 57 CLR 774

- **Dual Locations:** A taxpayer moved back and forth between a home in Western Australia and business interests in Darwin.
- **The Precedent:** The High Court ruled he was a resident of both locations, confirming a person can concurrently reside in more than one place.

(ab) Extended Definition of "Resident"

- **Statutory Expansion:** The legislation expands residency via three statutory tests: the domicile test, the 183-day test, and the superannuation test.
- **Global Catch:** These statutory rules capture individuals who do not reside in Australia under ordinary concepts but maintain significant permanent ties or presence in the country.

FCT v Applegate (1979) 79 ATC 4307

- **Expatriate Solicitor:** A solicitor moved from Sydney to Vanuatu to establish a branch office under an indefinite contract.
- **The Precedent:** The court ruled that a "permanent place of abode" does not mean everlasting, but rather non-temporary, making him a non-resident.

FCT v Jenkins (1982) 82 ATC 4098

- **Bank Employee Relocation:** A bank worker was transferred to London for three years but returned early due to ill health.
- **The Precedent:** The court held he had established a permanent place of abode abroad, proving a fixed, short-term lease can suffice.

Harding v FCT [2019] FCAFC 29

- **Middle East Apartment:** A taxpayer lived in temporary apartments in Bahrain while his family remained in a temporary house in Australia.
- **The Precedent:** The Full Federal Court clarified that "place of abode" refers to a specific country or town, not just a specific building structure.

(b) Companies

- **Corporate Residency Test:** Under section 6(1), a foreign-incorporated company becomes an Australian resident if it carries on business here and has its central management and control in Australia.
- **Voting Power Alternative:** Alternatively, a company is a resident if Australian resident shareholders control the majority of its voting power.

Koitaki Para Rubber Estates v FCT (1940) 64 CLR 15

- **Papuan Plantation:** A company operated rubber plantations in Papua, but its directors met and made all key choices in Sydney.

- **The Precedent:** The High Court ruled the company was strictly an Australian resident because its central management and control sat in Sydney.

Unit Construction Co v Bullock [1960] AC 351

- **African Subsidiaries:** African companies were legally managed by local boards, but a UK parent company actually dictated all decisions.
- **The Precedent:** The House of Lords ruled residency is determined by where real management happens, not where it is legally supposed to happen.

Malayan Shipping Co v FCT (1946) 71 CLR 156

- **Singapore Charter:** A company was registered in Singapore, but its managing director lived in Australia and ran all operations from there.
- **The Precedent:** The High Court found that exercising central management and control within Australia constitutes carrying on business in Australia.

Bywater Investments Pty Ltd v C of T [2016] HCA 48

- **Foreign Nominee Directors:** Overseas companies used foreign nominee directors who merely rubber-stamped decisions made by an accountant in Sydney.
- **The Precedent:** The High Court ruled the companies were Australian residents because their actual mind and management was located in Australia.

(4) Source

Income Tax Assessment Act 1997, s 995-1 & Income Tax Assessment Act 1936, s 6C

- **S 995-1 (Definitions):** Section 995-1 contains the structural dictionary for the 1997 Act, routing complex jurisdictional concepts back to foundational definitions in the 1936 Act. [1, 2, 3]
- **S 6C (Royalty Source Deeming):** This section acts as a statutory overriding rule, explicitly deeming royalties paid to non-residents by an Australian resident or business to have an Australian source. [1]

(a) Sale of Goods

- **Location of Contract:** The source of income from merchandise trading is generally located where the contract of sale is negotiated, concluded, and executed. [1, 2, 3]
- **Business Operations:** If a business is highly structured, courts will look beyond the final signature to where the core profit-making activities and operational assets are situated. [1]

(b) Provision of Services

- **Performance Rule:** For individual labor, the legal source of employment or services income is almost always located where the work is physically performed by the employee. [1]

- **Contract/Payment Location:** Where a contract is signed or where the money is disbursed is generally treated as secondary or incidental to the physical site of labor.

FCT v French (1957) 98 CLR 398

- **New Zealand Engineer:** An engineer employed by an Australian firm spent two weeks performing technical site work over in New Zealand.
- **The Precedent:** The High Court ruled that the source of his salary for those two weeks was New Zealand, cementing the rule that labor is sourced where it is performed. [1]

FCT v Mitchum (1965) 113 CLR 401

- **Hollywood Actor:** A famous actor was contracted by a Swiss company to perform movie consulting services in Australia for a fixed salary.
- **The Precedent:** The High Court clarified that French's Case is not a rigid rule of law; exceptional service contracts can look to contract formation or business location over physical performance. [1]

(c) Interest

- **Contract and Debt Location:** The source of interest income is determined by where the loan agreement was made and where the debt funds were advanced. [1, 2]
- **Security Location:** The physical location of any asset securing the loan is a secondary consideration subordinate to where the money was actually provided.

(d) Dividends

- **Profit Source Rule:** The source of a dividend is tied to the physical location where the company generated the underlying profits being distributed. [1]
- **Registry Location:** The place where the company is incorporated or where its share registry is maintained is legally irrelevant to dividend sourcing. [1]

Esquire Nominees v FCT (1973) 73 ATC 4114

- **Norfolk Island Structure:** An Australian accounting firm funneled profits through a chain of holding companies located on Norfolk Island.
- **The Precedent:** The High Court held that the dividend source was Norfolk Island because that specific company's immediate fund pool had no Australian source, looking strictly at the immediate distributing entity.

(e) Royalties

- **Intellectual Property Source:** At common law, the source of a royalty is where the property, patent, or knowledge was originally created or is legally used.
- **Statutory Overrule:** This common law rule is heavily modified by Section 6C, which forces an Australian source if the royalty is paid as an expense by an Australian business.

FCT v United Aircraft Corporation (1943) 68 CLR 525

- **US Engine Designs:** A US manufacturer licensed aircraft engine designs to an Australian company under a contract signed in New York, with payments sent there.
- **The Precedent:** The High Court ruled at common law that the income was non-Australian because the knowledge was created and held entirely in America, which ultimately prompted the enactment of Section 6C. [1, 2]

(5) Derivation

Income Tax Assessment Act 1997, s 6-5

- **Core Timing Provision:** Section 6-5 dictates that a taxpayer's assessable income includes ordinary income derived directly or indirectly during the income year. [1, 2]
- **Deemed Derivation:** Under subsection 6-5(4), income is legally taken to be derived by a person as soon as it is dealt with on their behalf or as they direct, even if it hasn't changed hands. [1, 2]

(a) Appropriate Method of Recognition of Income: Cash/Accruals

- **Method Choice:** Taxpayers must use either the receipts (cash) method or the earnings (accrual) method to decide exactly when an income amount has been officially derived. [1, 2]
- **Objective Test:** The chosen framework must match the taxpayer's operational reality to give a substantially correct reflex of their true income. [1, 2]

C of T (SA) v Executor Trustee (Carden's Case) (1938) 63 CLR 108

- **Medical Practice Dispute:** The Commissioner sought to tax the outstanding fees of a deceased sole-practitioner doctor using an accrual framework rather than cash receipts. [1]
- **The Precedent:** The High Court ruled that a cash basis was the most appropriate method because a professional's true income is best reflected by what has actually come home to them.

(b) Salary and Wages

- **Receipts Basis Default:** Remuneration from an employment relationship is almost exclusively recognized on a receipts method once payments are actually or constructively collected.
- **No Accrual Rule:** An employee does not derive income when they complete a shift or receive a payslip, but strictly when the employer shifts money to their control.

(c) Trading Income

- **Earnings Basis Default:** Income from commercial buying, manufacturing, and selling goods must be brought to account under an accrual accounting method. [1, 2]
- **Debt Recognition:** Sales revenue is legally derived the precise moment a commercial transaction concludes and a recoverable debt is established.

J Rowe and Sons v FCT (1971) 124 CLR 421

- **Installment Retailer:** A retail company sold consumer goods via long-term installment plans but wanted to report income only as cash arrived.
- **The Precedent:** The High Court held that for trading businesses, profits are derived when the sale is made and a debt arises, making the accrual method mandatory. [1, 2]

(d) Income from Professional Practice

- **Scale and Structure:** Small sole-traders often qualify for cash accounting, but larger practices relying on employees and capital must use accruals.
- **Recoverable Debt Threshold:** In larger firms, income is derived when the work is billed or a formal recoverable debt emerges, rather than waiting for invoice payment. [1, 2]

Henderson v FCT (1970) 119 CLR 412

- **Large Accountancy Firm:** A massive multi-partner accountancy firm attempted to report its taxable returns using a simplified cash receipts framework.
- **The Precedent:** The High Court ruled that a large partnership relying on collective staff labor must use the accruals basis, as unbilled work-in-progress is not yet derived income.

FCT v Firstenberg (1976) 76 ATC 4141

- **Sole Solicitor:** A sole practitioner lawyer running a small office with minimal administrative staff reported his taxes using a cash basis.
- **The Precedent:** The Supreme Court confirmed that a cash receipts method was correct for a single professional whose income is tied directly to his personal exertion and skills.

Barrett v FCT (1992) 92 ATC 4275

- **Medical Practice Associates:** Pathologists working together in a practice model disputed whether their billings were derived at execution or payment.
- **The Precedent:** The court affirmed that if a medical practitioner's fees are heavily dependent on third-party billing networks, the accruals method gives the true income reflex.

(e) Prepaid Income

- **Unearned Revenue Status:** Cash collected before a service is delivered is temporarily treated as a liability rather than derived income.
- **Earning Hurdle:** The money transitions into assessable income only when the business performs its specific contract obligations.

Arthur Murray (NSW) v FCT (1965) 114 CLR 314

- **Prepaid Dance Lessons:** A dance studio collected upfront fees for blocks of future lessons but explicitly refused to issue contract refunds.

- **The Precedent:** The High Court ruled that upfront cash is not derived until the lessons are physically delivered, as the revenue remains unearned until performance.

(6) Exempt income

Income Tax Assessment Act 1997, Division 11

- **Statutory Directory:** Division 11 acts as a centralized index that lists all types of exempt and non-assessable non-exempt income across the tax legislation.
- **Structural Role:** It provides a clear navigational roadmap to help taxpayers find specific exclusions scattered throughout the Act.

Income Tax Assessment Act 1997, Division 50

- **Entity Exemptions:** Division 50 completely exempts the total ordinary and statutory income of specific categories of organizations from tax obligations. [[1](#), [2](#)]
- **Qualifying Entities:** It covers non-profit bodies, registered charities, public educational institutions, scientific research funds, and amateur sporting associations. [[1](#), [2](#)]

Income Tax Assessment Act 1997, Division 51

- **Specific Item Exemptions:** Division 51 exempts specific types of receipts from tax, regardless of the nature of the entity receiving them.
- **Covered Payments:** It primarily shields defensive force allowances, welfare benefits, government education scholarships, and specific disaster relief payments.

2. Income from Personal Services

(1) Income according to ordinary concepts

Income Tax Assessment Act 1997, s 6-5

- **Core Provision:** Section 6-5 explicitly includes ordinary income—defined as income according to ordinary concepts—in a taxpayer's assessable income. [[1](#), [2](#), [3](#), [4](#)]
- **Jurisdictional Reach:** It dictates that Australian residents are taxed on ordinary income from worldwide sources, whereas non-residents are only taxed on ordinary income derived from Australian sources. [[1](#), [2](#), [3](#)]

FCT v Dixon (1952) 86 CLR 540

- **Military Top-Up:** An employer voluntarily paid top-up cash to an employee who left his regular job to enlist in the armed forces during World War II. [[1](#)]