Taxation

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Topic 1: General principles

Key cases/legislation

Tennant v Smith [1892], FCT v Cooke and Sherden (1980) – income - Must be of money or money's worth

IRC v Lysaght [1936] AC 234, Gregory v DFCT (1937) – *individual – ordinary meaning of resides*

Australian Constitution ss 51(ii) and 55.

Income Tax Rates Act 1986

Income Tax Assessment Act 1936 (ITAA 1936)

Income Tax Assessment Act 1997 (ITAA 1997)

Taxation Administration Act 1953,

A New Tax System (Goods and Services Tax) Act 1999

Fringe Benefits Tax Assessment Act 1986.

Main concept

Overview of Australia's income tax system, tracing its historical development, constitutional foundations, and dual legislative framework (*ITAA 1936 and ITAA 1997*), while distinguishing between ordinary income and statutory income as defined in *s 6-5 and s 6-10 ITAA 1997*.

It also covers judicial principles for characterising income (e.g. *Scott v FCT, Cooke & Sherden*), introduces types of income (personal exertion, property, business), and outlines factors relevant to determining whether receipts are assessable under ordinary concepts or statutory provisions.

Sources of Tax Law: Tax legislation, case law, and ATO publications and guidance.
Financial Year: The amount of income tax payable is usually determined for the 12 months ending 30 June each year (section 410 subsection 1).
Taxable Income = Assessable Income - Deductions.

Historical origins and evolution

Pre-Federation:

- Six self-governing colonies (now states) raised revenue from customs and excise duties, creating trade barriers.
- Some states introduced income tax on dividends in the late 19th century.
- **Federation (1901):** Removed trade barriers between states.
- **World War I (1915):** Federal government introduced federal income tax in addition to state taxes to fund war efforts.
- **1923:** Some harmonisation occurred, with state officials collecting federal income taxes.
- **1936: Income Tax Assessment Act:** Commonwealth legislation amended and consolidated.
- **World War II (1942):** Federal government created a uniform income tax system, with states relinquishing income tax powers.
- **1980s:** Introduction of capital gains tax (CGT) in 1985 and fringe benefits tax (FBT) in 1986
- **1999:** GST introduced.
- **High Court Cases (Capital M60 2024, B48 2024):** These cases challenge the extent of Commonwealth and State taxing powers, particularly concerning surcharge land tax levied on foreign persons and non-discrimination clauses in double tax treaties.

Economic theory

Economic theory in respect of taxes generally:

- differences between direct taxes (e.g., income tax) and indirect taxes (e.g., GST);
- fairness: direct taxes are from a social perspective considered progressive as compared to indirect taxes that are regressive;
- costs of collection;
- simplicity: relevance of the tax base to the simplicity of the tax and the rate; and
- the use of the tax regime to achieve policy objectives of the government

Legislative framework

Constitutional Basis:

The Commonwealth's power to make taxation laws stems from the Constitution, specifically:

- *Section 51(ii):* Grants the power to make laws regarding "Taxation; but so as not to discriminate between States or parts of States."
- *Section 55*: Stipulates that "Laws imposing taxation shall only deal with the imposition of taxation, and any provision therein dealing with any other matter shall be of no effect."

Two-act system

The restriction in Section 55, means the Cth uses two separate Acts to impose tax.

- **Tax (or Rating) Act:** This act imposes the tax and specifies the rate (e.g., *Income Tax Rates Act 1986*).
- **Assessment Act:** This act determines the amount on which the tax is imposed and

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contains the machinery provisions (e.g., *Income Tax Assessment Act 1997*).

Tax Law Improvement Project (TLIP): Initiated in 1993 to rewrite the *Income Tax Assessment Act 1936 (ITAA 1936)* into a more user-friendly format, resulting in the *Income Tax Assessment Act 1997 (ITAA 1997)*. While the *ITAA 1997* contains most of the relevant provisions, it cross-references provisions in the *ITAA 1936* where they haven't been rewritten.

The *ITAA 1997* operates from 1 July 1997, along with provisions cross-referencing the *ITAA 1936*.

The *ITAA 1936* continues to operate for the 1996-97 income year and earlier income years.

Cross-references to the ITAA 1936 are expected to diminish and eventually eliminated by reason of the ITAA 1997 being amended and updated over time.

Chapter 1 of *ITAA 1997*: Contains core provisions, starting with a Guide, reflecting the Act's design to allow taxpayers to proceed only as far as necessary.

Calculating Taxable Income

S4-10(3) – key provision of *ITAA 1997*.

Taxation Concepts		Accounting Concepts	
Assessable income	$XXX	Revenue	$XXX
Less Deductions	(XX)	Less Expenses	(XX)
Taxable Income	**$XXX**	**Net Profit**	**$XXX**

Formula: Taxable Income = Assessable Income - Deductions.

- *Section 4-10(3) ITAA 1997*: Defines taxable income as the amount by which assessable income exceeds deductions.

Assessable Income:

- Consists of ordinary income (s.6-5) and statutory income (s.6-10). An alphabetical listing of statutory income provisions is in s.10-5.
- Section 6-25 prevents double assessment, giving precedence to provisions other than s.6-5 unless a contrary intention exists.

Deductions:

- Consist of general deductions (s.8-1) and specific deductions (s.8-5). An alphabetical listing of specific deduction provisions is in s.12-5.
- Section 8-10 prevents double deductions, allowing deduction only once under the most appropriate provision.

Taxable income:

- is the amount by which assessable income exceeds deductions; s.4-10(3).
- Division 6 contains the core provisions as to amounts that are included in assessable income.
- Division 8 contains the core provisions as to deductions.

Tax Loss:

- Arises if deductions exceed assessable income (Division 36).

Concept of Income

***Ordinary Income* (s.6-5 ITAA 1997):**

The expression "income" isn't defined, but its legal meaning is drawn from judicial decisions and specific provisions. Eg: salary, wages, allowances, commissions, bonuses, director's fees.

Key characteristics include:

- Gains from organised activity (employment, business, profession).
- Gains derived from property that leave the property intact (fruit of the tree).
- Compensation substituting for gains that would have been income.
- Gains periodically received.

Broad categories of ordinary income:

1. Income from personal exertion.
2. Income from property.
3. Income from carrying on a business

Each of those topics is considered in the context of ordinary income and applicable statutory income provisions.

Statutory Income:

- Amounts of assessable income not regarded as income according to ordinary concepts.
- Included in assessable income under specific provisions of ITAA 1936 or ITAA 1997 (section 6.10 of the 1997 act).
- Includes net capital gains, franking credits, certain compensation payments, and reimbursements
- *Section 6.25 of the 97 act:* If an amount is assessed more than once, it is included only once in accessible income. Statutory provisions will prevail over the ordinary income provisions, unless the contrary intention appears

Provisions inserted to address:

- Adverse court decisions against the Commissioner.
- The need for certainty in complex transactions.
- Concessional tax treatment (e.g., employment termination payments).

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- Extension of the tax base (e.g., capital gains).

Basic principles for characterising a receipt as income:

- Must be of money or money's worth (*Tennant v Smith [1892], FCT v Cooke and Sherden (1980)*).
- Distinction between capital receipts and income receipts (tree vs. fruit).
  - Income as a flow vs. capital as the source.
  - *Eisner and McComa:* Income likened to the fruit or crop, capital to the tree or land.
  - Indicia of Capital Receipts: Payments that are not periodic, resulting from disposal of assets, relating to the underlying structure of a business, lump sum in nature, received when businesses cease, and compensation for lost capital.
- Nature of the receipt determined by its inherent character in the recipient's hands.

Income from Business

The threshold question is whether a business is being carried on.

Defined in s 995-1 ITAA 1997: includes profession, trade, employment, vocation or calling (excluding employment).

Indicators of a business

- Purpose of profit
- Scale of activities
- Commercial character of transactions
- Systematic and organised activities ("badges of trade")

Key Cases:

Spriggs v FCT: Business existence is a matter of fact and degree - assessed by multiple indicia (profit purpose, scale, commercial character, systematic activities).
FCT v Murray: Business involves continuity and repetition.
Re Devi and Hill v Commissioner: Lack of planning or commerciality indicates a hobby, not a business.
FCT v Stone: Income from sports activities may be ordinary income when commercialised.
Ferguson v FCT: Preparatory activities may suffice.
Brajkovic v FCT: Gambling activity not a business unless systematic.

Business income and non-cash benefits

s 21A ITAA 1936: Non-cash business benefits are assessable at market value if convertible to money.

- Ordinary business income includes receipts from normal business operations (sales, fees, commissions, IP, prizes).

Isolated transactions

A one-off transaction may still give rise to ordinary income if it forms part of a profit-making scheme.

Key Cases:

Myer Emporium Ltd v FCT: Receipt arising from assignment of interest rights held to be ordinary income. Isolated transactions with profit-making intention can be ordinary income; key for assessments.
FCT v Whitfords Beach: Distinction between income and capital. Land development after takeover = ordinary income.
Statham v FCT: Distinguishes realisation of capital from income.
Greig v FCT (2020): Deduction allowed where transaction was part of commercial activities.

Residence

Income Tax Assessment Act 1997, s 995-1

Income Tax Assessment Act 1936, s 6(1)

Individual

Residents taxed on worldwide income; foreign residents taxed only on Australian-sourced income.

Gneerally, determined by the ordinary meaning of "resides" (*IRC v Lysaght [1936] AC 234, Gregory v DFCT (1937*)) and the extended definition of "resident" (*FCT v Applegate (1979) 79 ATC 4307, FCT v Jenkins (1982) 82 ATC 4098, Harding v FCT [2019] FCAFC 29*).

Four tests:

1. **Resides Test/ordinary meaning test:**

- This is the ordinary meaning of “resides”.
- Interpreted according to common law.
- Relevant considerations:
  - Physical presence.
  - Family and social ties.
  - Living arrangements.
  - Time spent in Australia and abroad.
- The word “resides” is interpreted using cases such as *IRC v Lysaght and Gregory v FCT.*
- An individual can have more than one place of residence (e.g., Australia and overseas simultaneously).
- *Harding v FCT [2019]* clarified that a "place of abode" can include temporary or shifting locations (e.g., multiple hotels).
- *Applegate:* A person temporarily absent may still “reside” in Australia if they retain sufficient connections.

2. **Domicile and Permanent Place of Abode Test**

Requires both:

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