Week 2: Ch8, Ch 48, Ch 9

Chapter 8 : Income Tax

Income Tax Legislation

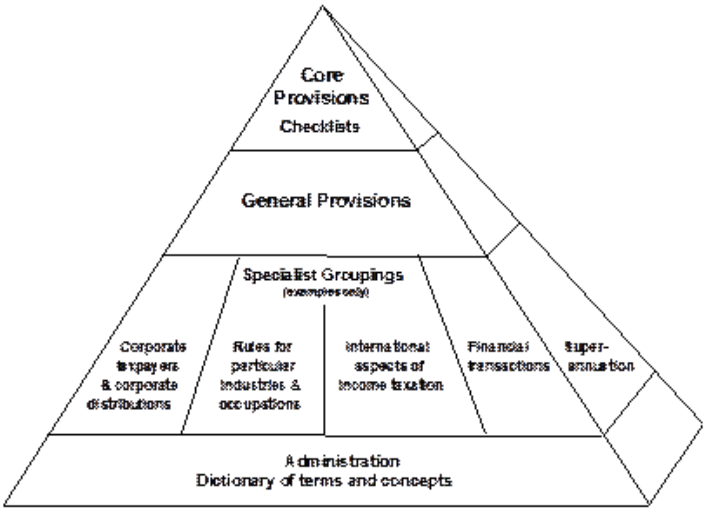
- ITAA36 and ITAA97 establish the income TAX BASE
- ITAA36 and ITAA97 must be read in conjunction with other Acts
    - (i.e International tax Agreements Act 1953)
    - Taxation Administration Act 1953 (TAA)
    - Income TAx (Transitional Provisions) Act 1997 (ITTPA)
- ITAA36 and ITAA97 operate alongside the
    - Income Tax Regulations 1936
    - Income Tax Assessments Regulations 1997
- Income Tax Act 1986:
    - Imposes income tax on a taxpayer's taxable income
- Income Tax Rates Act 1986
    - Sets out rates of tax for different tax payers

Tax Law Improvement Project

- TLIP established to rewrite ITAA36 in a simpler manner
- TLIP resulted in the introduction of ITAA97, which has new:
    - Structure
    - Language
    - Numbering
    - Layout
- Continued operation of:
    - Precedent (s 1-3 ITAA97)
    - Rulings (s 357-95, Sch 1 TAA)

Style of the ITAA97

- Divided into chapters:
    - Chapter 1 – Introduction and core provisions
    - Chapter 2 – Liability rules of general application
    - Chapter 3 – Specialist liability rules
    - Chapter 4 – International Aspects of Income tax
    - Chapter 5 – Administration
    - Chapter 6 – Dictionary



Style of the ITAA36

ITAA36 is divided into Parts:
Part I – Preliminary
Part II – Administration
Part III – Liability to taxation
Part IV – Returns and assessments
Part IVA – Schemes to reduce income tax
Part VA – Tax File Numbers
Part VI – Collection and recovery of tax
Part VIIB – Medicare levy and surcharge
Part VIII – Miscellaneous
Part X – Controlled foreign companies
Schedules – Special matters (eg trust losses)

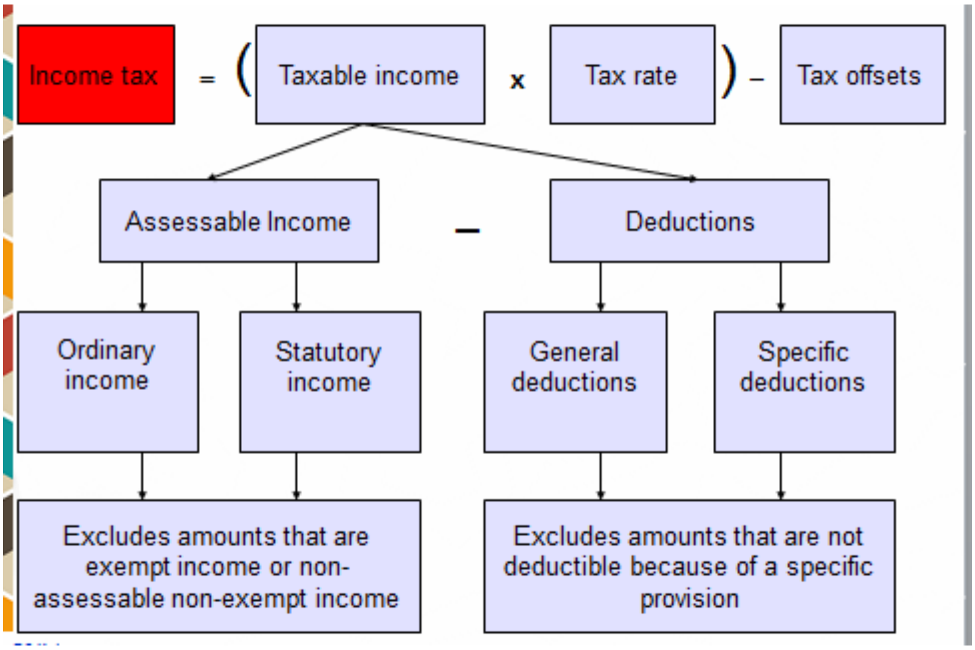
Subsequent Reforms

- TLIP has not been completed
- TLIP was superseded by ANTS reforms (A New Tax System)
- Remaining ITAA36 provisions will gradually be shifted into ITAA97
- Single Assessment Act is still some time away

Income Tax Overview

- Income tax is payable by a broad range entities including: (ITAA97 s 4-1, 9-1)
    - Individuals
    - Companies
    - Trustees of superannuation funds
- Most entities pay income tax on their TAXABLE INCOME for the INCOME YEAR (s 4-10)
    - For most entities, the income year is the same as the FINANCIAL YEAR (1 July to 30 June)
    - For companies, the income year is the PREVIOUS FINANCIAL YEAR

Income Tax Formula



- INCOME TAX = (Taxable Income x Tax Rate) – Tax Offsets
    - S 4-10 (3)
- TAXABLE INCOME = Assessable Income – Deductions
    - S 4-15 (1)

Assessable Income

- ORDINARY INCOME:
    - Amounts that are income under the common law
    - Salary, interest, rent
    - S 6-5
- STATUTORY INCOME
    - Amounts that are specifically included in assessable income
    - Checklist in Div 10 ITAA(7
    - S 6-10
- Both excludes amounts that are:
    - Exempt income
    - Non assessable non-exempt income
- S. 6-25
    - Insures the amount is assessable ONCE (i.e dividends can fall under both)

Exempt & non-assessable non-exempt income

- Assessable income does not include ordinary income or statutory income that is:
    - EXEMPT INCOME; income made exempt by a provision in ITAA36, ITAA97 or another Commonwealth law
        - Checklist in Subdiv 11-A ITAA97
        - S 6-20
    - NENA; income stated to be NANEI by a provision in ITAA36, ITAA97 or another Commonwealth Law
        - Checklist in Subdiv 11 –B ITAA(7)
        - S 6-23

Deductions

- GENERAL DEDUCTIONS
  - Losses or outgoings that satisfy the requirements of the general provision in s 8-1
- SPECIFIC DECUCTIONS
  - Losses or outgoings that satisfy the requirements of a specific deduction provision
  - Checklist in Div 2 ITAA97
- S8-10
  - Limits deductions (i.e entertainment expenditure or self-education expenses)

Limits on deductions

- The general and specific deduction provisions operate subject to a range of provisions in ITAA36 and ITAA97 that limit or deny deductions

Tax Losses

- Income tax is not payable where an entity makes a tax loss
- Tax losses can be carried forward and used as DEDUCTIONS in future income years
- Tax loss arises where:
  - DEDUCTIONS > (Assessable Income + Net exempt income)

Tax Rates

- Income tax is imposed on a taxpayer's taxable income at rates set out in the INCOME TAX RATES ACT 1986
- Individuals pay tax at MARGINAL RATES (up to 45%) that vary depending on the level of heir taxable income and whether they are RESDIENTS or NON-RESIDENTS
- Companies generally pay tax at the corporate tax rate of 30%
  - Special rates apply to certain companies
- TRUSTEES of complying superannuation funds generally pay tax at the rate of 15%
- TRUSTEES of non-complying superannuation funds pay tax at the rate of 45% (for 2014/2015)

Resident Individual Tax Rates

Resident individual tax rates since 2012/13	
Taxable income	**Tax**
0–$18,200	Nil
$18,201–$37,000	19% on excess over $18,200
$37,001–$80,000	$3,572 on $37,000 plus 32.5% on excess over $37,000
$80,001–$180,000	$17,547 on $80,000 plus 37% on excess over $80,000
$180,001 and above	$54,547 on $180,000 plus 45% on excess over $180,000

Non-Resident Individual Tax Rates

Non-resident individual tax rates since 2012/13	
Taxable income	**Tax**
0–$80,000	32.5% on excess over Nil
$80,001–$180,000	$26,000 on $80,000 plus 37% on excess over $80,000
$180,001 and above	$63,000 on $180,000 plus 45% on excess over $180,000

Tax Offsets

- Tax Offsets reduce a taxpayer's 'basic income tax liability'
- ITAA36 and ITAA97 contain around 50 different tax offsets which have complex eligibility criteria and numerous exclusions and 'phase out' rules
- Checklist located in s13-1 ITAA97
- Tax offsets are subtracted from tax payable on TAXABLE INCOME
- INCOME TAX = (Taxable Income x Tax Rates) – Tax Offsets

Difference between a TAX OFFSET and a TAX DEDUCTION

- $1 TAX OFFSET = TAX LIABILITY reduced by $1
- $1 DEDUCTION = Taxable income reduced by $1

Nature of a tax offset

- Tax offsets are commonly known as rebates or credits
- Generally tax offsets:
    - Cannot be applied to reduce a taxpayer's other tax liabilities (i.e GST, FBT, TBRL, Medicare Levy, Medicare Levy surcharge)
    - Cannot be refunded
- Exceptions that exist:
    - Franking credits
    - Private health insurance tax offset
    - R&D tax offset
    - Film and production tax offset
    - Concessional Tax Offset

Concessional Tax offset

1) Low Income Tax offset for resident individuals

- The LITO is a special tax offset that reduces the tax liability of resident individuals who have low taxable incomes
- LITO = $445
- This amount reduces by 1.5 cents for every dollar that the person's taxable income exceeds $37,000
- It is phased out once their taxable income reaches $66,667

2) Net medical expenses tax offset

- Applies to resident individuals who incur unreimbursed medical expenditure on behalf of themselves and their resident dependants
- From 1 July 2012, the tax offset applies at the rate of either 10% or 20% to so much o a taxpayer's unreimbursed medical expenses as exceeds one of two annually index "PHASE IN LIMITS"
- Tax OFFSET is being phased out
    - Taxpayers can now only claim the tax offset for medical expenses that relate to disability aids, attendant care or approved aged care unless they fall within a SPECIAL TRANSITIONAL RULE
        - Can still claim if they have claim it in previous years

Medical expenses tax offset rates (2013/14)			
Taxpayer	**Adjusted taxable income**	**Rebatable medical expense amounts**	**Rate of tax offset**
Singles	$88,000 or less	$2,162 or less	0%
		More than $2,162	20%
	More than $88,000	$5,100 or less	0%
		More than $5,100	10%
Families*	$176,000 or less	$2,162 or less	0%
		More than $2,162	20%
	More than $176,000	$5,100 or less	0%
		More than $5,100	10%

* The adjusted taxable income threshold for families increases by $1,500 for each dependent child after the first.

3) Private Health Insurance Tax Offset

- Applies to individuals for the cost of taking out PRIVATE HEALTH INSURANCE, provided the individual has not received this incentive by way of:
    - A reduced health insurance premium
    - A direct government payment

Private health insurance tax offset rates (2013/14 and 2014/15)									
Income for surcharge purposes	Singles	Up to $88,000		$88,001 – $102,000		$102,001 – $136,000		More than $136,000	
	Families*	Up to $176,000		$176,001 – $204,000		$204,001 – $272,000		More than $272,000	
Income year		2013/14	2014/15	2013/14	2014/15	2013/14	2014/15	2013/14	2014/15
Age of single person or oldest person in a family	Less than 65	30%	29.04%	20%	19.36%	10%	9.68%	0%	0%
	65 to less than 70	35%	33.88%	25%	24.20%	15%	14.52%	0%	0%
	70 and above	40%	38.72%	30%	29.04%	20%	19.36%	0%	0%

* The income for surcharge purposes thresholds for families are increased by $1,500 for each additional dependent child after the first child.

Credit related Tax Offsets

- Franking Credits tax offset

    - Applies to resident entities that receive "FRANKED DISTRIBUTIONS" from companies
    - Tax offset is generally equal to the FRANKING CREDIT
- Foreign income tax offset
    - Applies to taxpayers who pay foreign tax on their income
    - Generally, tax offset is the amount of the foreign tax paid on the income but it cannot exceed the Australian tax paid on the income

Additional levies payable by individuals

- Resident individuals may be required to pay additional levies and charges on top of their income tax
- These include the:
    - TBRL
    - Medicare Levy
    - Medicare Levy Surcharge
    - HELP repayments
- Resident individual taxpayers overall tax liability is calculated as:
    - TAX LIABILITY = INCOME TAX + TBRL + ML + MLS + HELP

Temporary Budget Repair Levy

- TBRL imposes additional income tax on resident and non-resident individuals with taxable incomes in excess of $180,000
- Additional income tax is 2% of so much of the individual's income that exceeds 180,000
- TBRL is only payable in respect of the TBRL years:
    - 2014/15
    - 2016/17
- As a consequence of TBRL, a number of other tax rates that have been traditionally set by reference to the top marginal income tax rate plus ML have been increased by 2% for 14/15 and 16/17

Medicare Levy

- Resident individuals are generally liable to pay a medicare levy at the rate of 2% for 2014/15
- Increased from 1.5% due to the NATIONAL DISABILITY INSURANCE SCHEME
- Medicare levy operates subject to income threshold and PHASE-IN RULES
- Non-resident individuals do not pay the MEDICARE LEVY
- NOTE CORRECTION ON DIAGRAM BELOW (1.5%)

Medicare levy thresholds and phase-in limits (2013/14)

Taxpayer	Threshold	Phase-in limits	Full 2% levy
Singles	$20,542	$20,543 to $24,167	More than $24,167
Families (no children)	$34,367	$34,368 to $40,431	More than $40,431
Families (1 child)	$37,523	$37,524 to $44,144	More than $44,144
Families (2 children)	$40,679	$40,680 to $47,857	More than $47,857
Families (3 children)	$43,835	$43,836 to $51,570	More than $51,570
Pensioners	$32,279	$32,380 to $37,975	More than $37,975

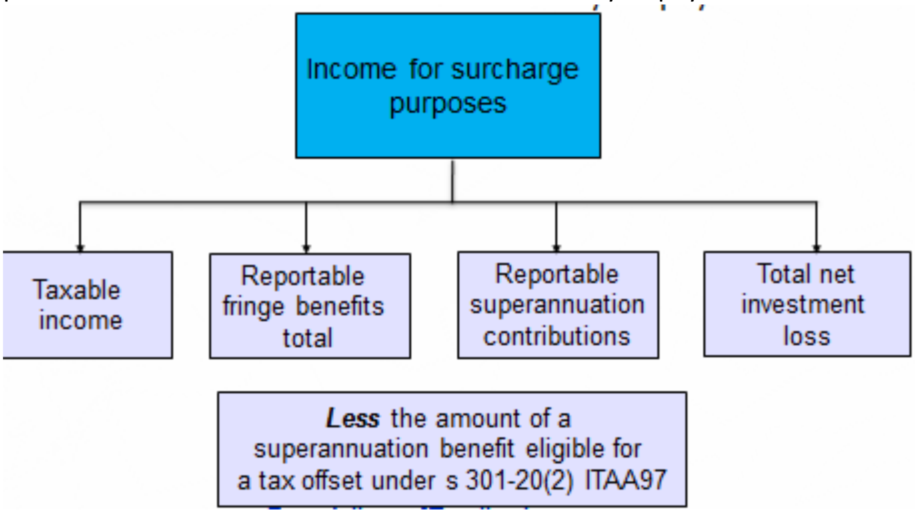
Medicare Levy Surcharge

- The Medicare Levy surcharge applies if a resident individual's (or if a couple, a FAMILY) 'INCOME FOR SURCHARGING PURPOSES" for an income year exceeds a specified threshold and they are not covered by private health insurance
- The MLC is imposed at a rate of 1%, 1.25% or 1.5% on their TAXABLE INCOME and REPORTABLE FRINGE BENEFITS TOTAL

Medicare levy surcharge rates (2013/14 and 2014/15)				
2013/14 income for surcharge purposes	Singles	$88,001 to $102,000	$102,001 to $136,000	More than $136,000
	Families*	$176,001 to $204,000	$204,001 to $272,000	More than $272,000
2014/15 income for surcharge purposes	Singles	$90,001 to $105,000	$105,001 to $140,000	More than $140,000
	Families*	$180,001 to $210,000	$210,001 to $280,000	More than $280,000
Rate		1%	1.25%	1.5%
* The income for surcharge thresholds for families are increased by $1,500 for each additional dependent child after the first child.				

Income for Surcharge Purposes

- Income for surcharge purposes is relevant for determining a taxpayer's entitlement to the private health insurance tax offset and their liability to pay the MLS



The Higher Education Loan Program (HELP)

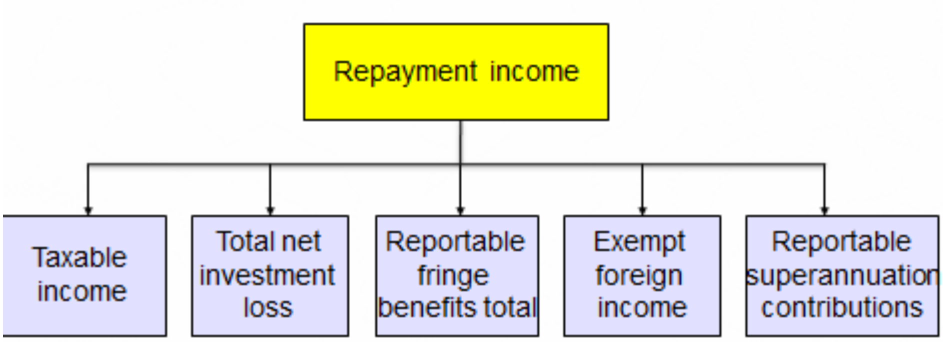
- HELP consists of:
    - HECS-HELP (for eligible Commonwealth supported students)
    - FEE-HELP (for eligible fee-paying students)
    - OS-HELP (for eligible Commonwealth supported students studying overseas during their courses)

Repayment of HELP debts

- HELP debts:
    - May be voluntarily paid off at any time
    - Must be repaid under the TAX SYSTEM where REPAYMENT INCOME exceeds prescribed annual threshold amount
- The rate of repayment varies depending on the level of the person's REPAYMENT INCOME

Repayment Income

- Repayment income is relevant for determining a taxpayer's liability to make HELP payments



- REPAYMENT INCOME:
  - Taxable income
  - Total net investment loss
  - Reportable fringe benefits total
  - Exempt foreign income
  - Reportable superannuation contributions

HELP repayment rates		
2013/14 repayment income	2014/15 repayment income	Repayment rate
Below $51,308	Below $53,345	Nil
$51,308 – $57,153	$53,345 – $59,421	4%
$57,154 – $62,997	$59,422 – $65,497	4.5%
$62,998 – $66,308	$65,498 – $68,939	5%
$66,309 – $71,277	$68,940 – $74,105	5.5%
$71,278 – $77,194	$74,106 – $80,257	6%
$77,195 – $81,256	$80,258 – $84,481	6.5%
$81,257 – $89,421	$84,482 – $92,970	7%
$89,422 – $95,287	$92,971 – $99,069	7.5%
$95,288 and above	$99,070 and above	8%

Other relevant concepts to calculating income tax liability

- Number of important concepts relevant in calculating TAX LIABILITY
  - Rebate Income
  - Adjusted Taxable Income
  - Income for Surcharge Purposes
  - Repayment Income
- These are made up by:
  - Reportable employer superannuation contributions
  - Reportable superannuation contributions
  - Reportable fringe benefits total
  - Adjusted fringe benefits total
  - Total net investment loss

Chapter 48 Identification and Payment Systems

Introduction

- Australia's taxation system is underpinned by the following identification and payment systems:
    - TFN system
    - ABN system
    - PAYG system
- In addition, the FINANCIAL TRANSACTION REPORTING REGIME; assists in the administration and enforcement of the tax laws

TFN System

- TFN system contained in Part 5A ITAA36
- TFN = are personal numbers that identify taxpayers and are used for AUDIT and data-matching purposes by the ATO
- Quoting TFN is optional, but if it is not quoted;
    - PAYG withholding consequences will arise
- Failure to quote a TFN to a superannuation fund results in extra tax on assessable contributions

ABN System

- ABN system designed to make it easier for businesses to conduct dealings with government
- Entities that can register for an ABN:
    - Government departments and branches
    - Entities carrying on enterprises in Australia
    - Entities making supplies connected with Australia
    - Companies under the Corporations Act
- ABN's may generally be quoted on investments in place of TFNs
- GST-registered entities must quote their ABNs on tax invoices

PAYG Withholding Regime

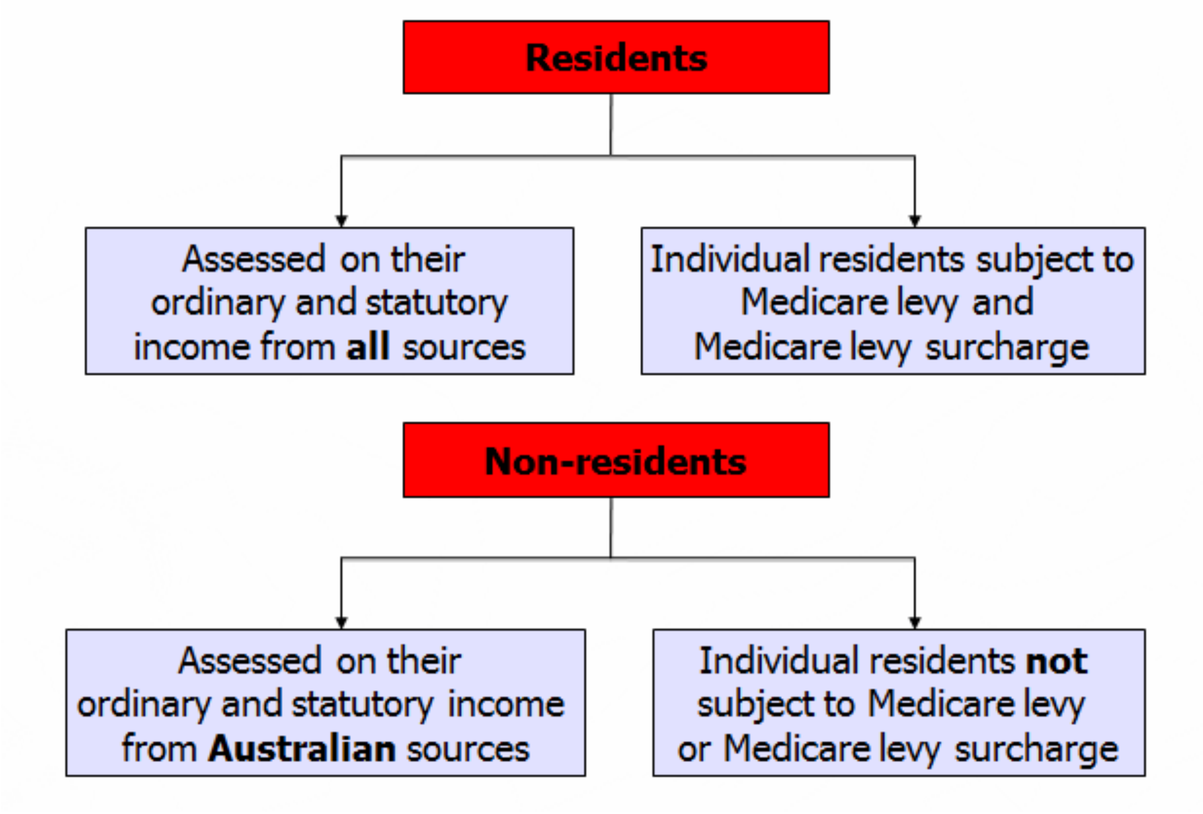
- PAY AS YOU GO
- Contained in Part 2-5 of Sch 1 TAA
- Payers must withhold tax from certain payments:
    - Payments of salary and wages to an employee
    - Payments for certain supplies where payee does not quote ABN
- Amounts withheld must be paid to the commissioner by specified dates that vary with the SIZE of the withholding entity
- Payees are entitled to credits for amounts withheld under the PAYG rules

PAYG Instalment Regime

- PAYG instalment regime contained in Part 2-10 of Sch 1 TAA
- Progressively collects tax over the income year
- PAYG instalments may be based on:
    - Taxpayer's GDP-adjusted notional tax
    - Taxpayer's estimate of its BENCHMARK TAX
    - Taxpayer's instalment income
- Instalments paid result in a credit against the taxpayer's actual tax liability

Chapter 9 : Residence and Source

General Jurisdictional rules



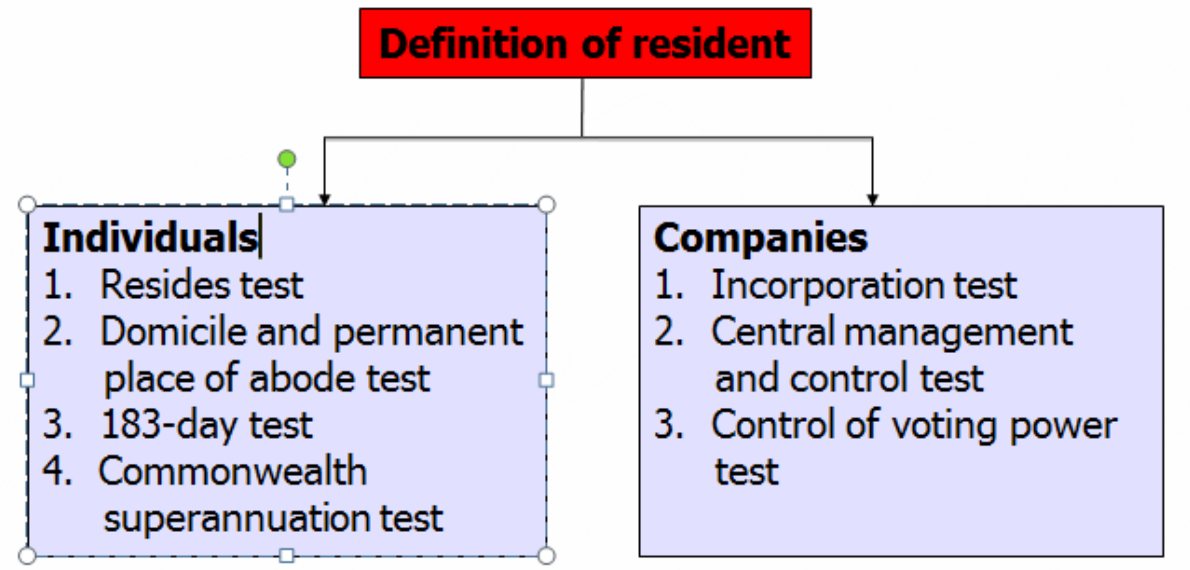
- RESDIENTS
    - Assessed on their ordinary and statutory income from ALL SOURCES
    - Individual residents subject to Medicare Levy and Medicare Levy surcharge
- NON RESIDENTS
    - Assessed on their ordinary and statutory income from AUSTRALIAN sources
    - Individual residents not subject to ML and MLS

- General jurisdictional rules operate subject to:
    - SPECIFC EXCEPTIONS

- INTERNATIONAL TAX EXEMPTIONS
- DOUBLE TAXATION AGREEMENT (DTA's)

- Special rules for:
  - Temporary residents
  - Taxpayers carrying on business through permanent establishments

Residence



Individuals

1) Resides Test

- Resident of Australia if the prson RESIDES in Australia
- Not defined in the legislation and can take ordinary meaning:
  - 'to dwell permanently or for a considerable time'
- Where the person resides is a question of fact
  - (FC of T v Miller 1946)
- Commissionaer has indicated in TR 98/17 to look at:
  - Quality and character of person's behaviour whilst in Australia
  - Taxpayer's intention or purpose of presence (i.e employment = resides)
  - Family and business (family = resides)
  - Maintenance and location of the taxpayer's assets (owns a house = resides)
  - Taxpayer's social and living arrangements (i.e enrol at a school – resides)

2) Domicile and Permanent Abode Test

- An individual is a resident of Australia if the prson's DOMICILE is in Australia unless the Commissioner is satisfied that the person's permanent place of abode is outside of Australia
  - S 6(1ai)
- Determined according to the DOMICILE ACT 1982 and the common law

  - Person acquire a ‘domicile of origin’; based on his.her parents and retains this until the person acquires a DOMICILE OF CHOICE (by choosing to make another country his/her home)
- Place of abode; where the person lives
  - (R v Hammond 1852)
- FC of T v Applegate
  - Permanent is not taken to mean EVERLASTING
  - Lawyer had a permanent abode outside Australia even though he intended to return
    - Did return due to illness after 2 years
  - Permanent abode was outside Australia due to substantial period of living outside the country
- FC of T vs Jenkins
  - Relied on Applegate
  - The period that he worked in New Hebrides, taxpayer’s permanent place of abode was in that country
- Will not have a permanent abode in Australia if:
  - He has not abandoned his home in Australia
  - Regarded as temporary or transitionary
- Comissioner’s view (IT 2650) takes into account these factors:
  1) Intended and actual length of the individual’s stay overseas
  2) Intention to return to Australia at some definite point in time
  3) Establishment of home outside of Australia
  4) Abandonment of residence in Australia
  5) Duration of the individual’s presence overseas
  6) Durability of association that the individual has with a place in Australia

183-day Test

- Considered a resident of Australia if he has BEEN IN Australia continuously or intermittently during more than one-half of the year of income, unless the Commissioner is satisfied that his usual place of abode is outside Australia & does not intend to take up residence in Australia
  - (s61aii)

Companies

1) Incorporation Test

- Resident = IF INCORPORATED IN AUSTRALIA
  - Even if it is controlled by foreign shareholders, managed overseas and carries on tis business overseas

2) Central Management and Control Test

- RESIDENT = if carries on business in Australia and has its CENTRAL MANAGEMENT CONTROL in Australia
  - Questions of fact (Malayan Shipping Company Ltd v FC of T 1946)

        - Located where its operations are controlled and directed (Koitaki Para Rubber v Fc of T 1941)
            - Where board of director meetings are held
- If parent company = then central management will be where the parent company's board meetings are held
    - (Unit Construction Co v Bullock)

3) Control of Voting Test

- Resides in Australia if it CARRIES ON BUSSINESS in AUSTRALIA and has its 'voting power controlled by shareholders who are residents of Australia'

Source

- Source of income is a question of fact
- Source of income depends on circumstances of each cases
- Where income is derived from more than one source, it may need to be apportioned between those sources

General Source Rules

- SERVICES INCOME:
    - Where the services are performed
- BUSINESS INCOME
    - Where the goods are sold or business is transacted
- INTEREST INCOME:
    - Loan – where the loan agreement is entered into and the money is lent
    - Business contract – where the contract was made
- Rental Income
    - Fixed property – where the property is located
    - Moveable property – where the lease agreement was entered into
- Royalty Income
- Dividend Income