RESIDENCY:

INDIVIDUALS:

A taxpayer who does not fall within the legislative definition of "Australian resident" is automatically considered a foreign resident for taxation purposes.
For tax purposes, a taxpayer may be a resident of more than one country.
Consistent with liability to tax being determined on a year-by-year basis, a taxpayer's residency status is also considered yearly.

ORDINARY CONCEPTS TEST:
It is a common law test that is somewhat circular and which requires a consideration of where a person resides.
The factors considered by the courts that provide evidence of residency are:
- Physical presence in Australia - It is necessary that the taxpayer spend at least some time physically present in Australia during the year of income.
- If the person is a visitor, the frequency, regularity and duration of visits - *IRC v Lysaght* (taxpayer living in one jurisdiction but visiting another with frequency and regularity).
- The purpose of the visits to Australia and abroad - Conversely, if the person is outside Australia for part of the income year in question, the purpose of the absence may also be relevant.
- The maintenance of a place abode in Australia for the taxpayer's use - whether a person has a home available for use in Australia.
- The person's family, business and social ties - the location of a person's family, business and social ties (*Levene v IRC*).
- The person's nationality - not normally be a relevant factor where other factors are clearly decisive. If a case is border line, nationality may be considered.

DOMICILE TEST:
Provides that a person is a resident of Australia if his or her domicile is in Australia, unless the commissioner is satisfied that the person has a permanent place of abode outside Australia.
Some factors, which will be taken into account in ascertaining whether a taxpayer has a permanent place of abode outside Australia as per *FCT v Applegate*:
- The intended and actual length of the taxpayer's stay in the overseas country.
- Whether the taxpayer intended to stay in the overseas country only temporarily and then to move on to another country or to return to Australia at some definite point in time.
- Whether the taxpayer has established a home (in the sense of dwelling place; a house or other shelter that is the fixed residence of a person, a family or a household) outside Australia.
- Whether any residence or place of abode exists in Australia or has been abandoned because of the overseas absence.
- The duration and continuity of the taxpayer's presence in the overseas country.

183-DAY TEST:
The second statutory test of residence - requires physical presence in Australia for more than one-half of the year - Applied to incoming individuals.
Under the test, an individual will be considered a resident of Australia where he or she is in Australia for more than 183 days, whether continuously or intermittently, unless the commissioner is satisfied that the person's usual place of abode is outside Australia and that he or she does not intend to take up residence in Australia.
The first part of the test is purely mathematical taking into account hours if necessary.
The second part of the test provides an exception. **There are two limbs to the exception:** The taxpayer has a usual place of abode outside Australia, and he or she did not intend to take up residence in Australia. Both of the limbs must be satisfied.
While usual place of abode will again mean something less than everlasting, this test is easier to satisfy than the requirement under the domicile test.
The second limb to the exception requires the Commissioner to be satisfied that the person does not intend to take up residence in Australia. This requires a consideration of the factors listed in the common law test of residence according to ordinary concepts.

SUPERANNUATION TEST:
The superannuation test applies to Commonwealth superannuation fund members and their families.
This test applies to relevant individuals who generally reside in Australia but leave temporarily and are not actually in Australia during the income year.

COMPANIES:

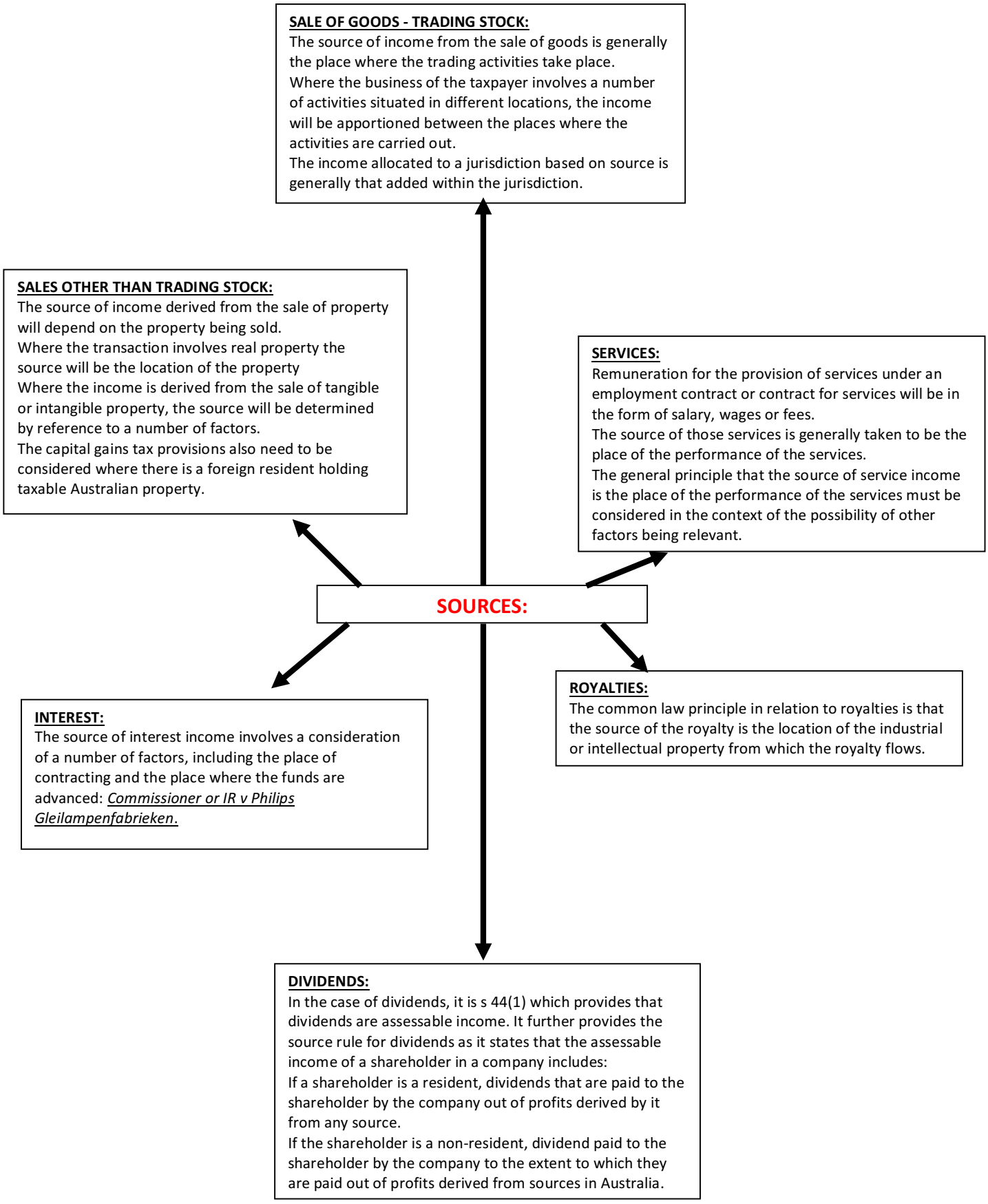
The definition of a resident in s 6(1) provides that a company is a resident of Australia where it is incorporated in Australia or, not being incorporated in Australia, where it carries on business in Australia and has either its central management and control in Australia or its voting power controlled by shareholders who are residents of Australia.

PLACE OF INCORPORATION TEST:
Under the first statutory test, a company incorporated in Australia is automatically a resident of Australia regardless of any other factors.
Whether a company is incorporated in Australia is a question of fact determined by reference to the Corporations Act.

CENTRAL MANAGEMENT AND CONTROL TEST:
A company is a resident of Australia if it carries on business in Australia and has its central management and control in Australia.
Test contains two limbs, both of which must be satisfied:
The first limb is that the company must carry on business in Australia. Determined by where the activities of the company are carried on, taking into account the facts and circumstances of the case.
The second limb is that the company's central management and control must be located in Australia. The location of the central management and control is also determined by the case.
Determining factors: The location of high-level decision-making processes, as well as monitoring the overall corporate performance. The central management and control of the company will be the location of the actual decision making, rather than the formal execution of the director's resolutions: *Malayan Shipping Co Ltd v FCT.*

CONTROLLING SHAREHOLDERS TEST:
The third statutory test provides that a company is a resident of Australia where its voting power is controlled by Australian residents and it carries on business in Australia. **This test contains two limbs:**
The first limb is that it is necessary to demonstrate that the voting power is controlled by Australian residents. The control of voting power appears to refer to the control of a majority.
The second limb of the test is that the company is carrying on business in Australia, is the same as it is for the central management and control test.

DUAL RESIDENCY AND TIEBREAKER PROVISIONS:
Both an individual and a company may be a dual resident.
Double tax agreements also contain definitions of "residency" for individuals and companies, which generally provide a tiebreaker rule where the taxpayer is considered a resident of both jurisdictions.
The most common tiebreaker rule for individuals is the taxpayer's permanent home or, if this does not resolve the issues, the place where the taxpayer has the personal social and economic ties.
The most common tie breaker rule for companies is the place of effective management.


SALE OF GOODS - TRADING STOCK:
The source of income from the sale of goods is generally the place where the trading activities take place.
Where the business of the taxpayer involves a number of activities situated in different locations, the income will be apportioned between the places where the activities are carried out.
The income allocated to a jurisdiction based on source is generally that added within the jurisdiction.
SALES OTHER THAN TRADING STOCK:
The source of income derived from the sale of property will depend on the property being sold.
Where the transaction involves real property the source will be the location of the property
Where the income is derived from the sale of tangible or intangible property, the source will be determined by reference to a number of factors.
The capital gains tax provisions also need to be considered where there is a foreign resident holding taxable Australian property.
SERVICES:
Remuneration for the provision of services under an employment contract or contract for services will be in the form of salary, wages or fees.
The source of those services is generally taken to be the place of the performance of the services.
The general principle that the source of service income is the place of the performance of the services must be considered in the context of the possibility of other factors being relevant.
SOURCES:
INTEREST:
The source of interest income involves a consideration of a number of factors, including the place of contracting and the place where the funds are advanced: Commissioner or IR v Philips Gleilampenfabrieken.
ROYALTIES:
The common law principle in relation to royalties is that the source of the royalty is the location of the industrial or intellectual property from which the royalty flows.
DIVIDENDS:
In the case of dividends, it is s 44(1) which provides that dividends are assessable income. It further provides the source rule for dividends as it states that the assessable income of a shareholder in a company includes:
If a shareholder is a resident, dividends that are paid to the shareholder by the company out of profits derived by it from any source.
If the shareholder is a non-resident, dividend paid to the shareholder by the company to the extent to which they are paid out of profits derived from sources in Australia.

DERIVATION OF INCOME:

DERIVATION:

It has become well established that unless the Act make some specific provision on the point the amount of income derived is to be determined by the application of ordinary business and commercial principles and that the method of accounting to be adopted is that which 'is calculated to give substantially correct reflex of the taxpayers' true income.

Timing of derivation:

An important step in calculating the taxpayer's assessable income is determining when that income has been derived in a tax year.

Sections 6-5(4) and 6-10(3) state that in working out whether you have derived an amount of ordinary income or statutory income, and (if so) 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.

The timing of the derivation of income will be dependent on whether the taxpayer is operating on a cash basis or an accruals basis.

CASH AND ACCRUAL ACCOUNTING:

Sections 6-5 and 6-10 leave it open to taxpayers to calculate their assessable income on a cash basis or an accruals basis.

For accounting purposes all financial statements are prepared on an accruals basis, but for taxation purposes tax returns can be prepared on an accruals basis as well as a cash basis.

Case law supports the contention that only professional practices and small-to-medium sized businesses should account on a cash basis if it is considered to be appropriate from a cash flow perspective.

There is nothing in the statutory law that compels taxpayers to adopt an accruals methods or cash methods to calculate the amount of taxable income they have gained in a particular financial year.

The approach taken by the ATO in the ruling is that trading income should be returned on an accruals or earning basis and income from non-trading activities such as specialised knowledge and skill; investment income and rent and royalties could be returned on a cash or receipts basis.

Any business eligible as a Small Business Entity can account on a cash or accruals basis. The SBE system replaced the STS from 1 July 2007 and the only test to be applied is that the entity must have an average turnover of less than $2 million.

In *Henderson v FCT* the High Court established the legal principle that with large professional firms the appropriate method to be used in calculating taxable income is the accruals system.

If a small business grows into a large business, then it may be appropriate for that business to change from accounting on a cash basis to an accruals basis for taxation purposes. The change would occur at the start of the new financial year.

If a taxpayer kept changing from cash to accruals system and then back again in order to derive tax-free income, then the ATO could assert that the taxpayer was engaged in tax avoidance under Pt IVA of ITAA 1936 and could impose penalties for such conduct.

PAYMENT BEFORE EARNING ACTIVITY HAS COMMENCED:

The question of recognising income may arise when a business receives a prepayment for goods or services and the goods or services which will be provided over a period of time and over more than one financial year.

Arthur Murray Pty Ltd v FCT illustrates the way in which the income is said to have been derived in these circumstances.

Sales under the lay-by method:

The situation may also arise where retail stores "sell" goods on an instalment basis and the legal title to the goods is not transferred nor the physical possession until full payment has been received.

In this case the income is only derived when legal title passes to the customer and not when the contract is entered into.

Income is only recognised when full payment has been made.

Dividend Income - When derived:

Dividends are assessable income pursuant to s 44(1).

The dividend is only treated as income in the hands of the shareholder when actually paid and not just declared by the directors.

The reason for this is because the directors can rescind the decision to pay the dividend at any time up until payment.

Derivation of income - Delay because of dispute:

If a taxpayer is owed money for goods sold, but the amount of money is subject to dispute, the question arises as to what stage that money should be brought to account as assessable income: when the dispute has been resolved or when the goods have been sold.

DERIVATION OF INCOME - EXPENSES AND PROVISIONS:

EXPENSES:

The taxation law treatment of the recognition of an expense even when not paid or the timing of the deduction of that expense differs from the financial accounting treatment of the deductibility of the expense.

Section 8-1 - General deductions:

(1) You can deduct from your assessable income any loss or outgoing to the extent that:
  (a) It is incurred in gaining or producing your assessable income.
  (b) It is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.

(2) However, you cannot deduct a loss or outgoing under this section to the extent that:
  (a) It is a loss or outgoing of capital, or of capital nature.
  (b) It is a loss outgoing of a private or domestic nature.
  (c) It is incurred in relation to gaining or producing you exempt income or your non-assessable non-exempt income.
  (d) A provision of this Act prevents you from deducting it.

If a taxpayer is accounting on a cash basis, then he or she can still claim a deduction for expenses that have been incurred but not paid for, a hybrid approach and, similarly, if accounting on an accrual basis, it can be deducted from assessable income.

It is not necessary to match the loss or outgoing with the income earned in the same income year, at least where a continuing business is involved.

Placer Pacific Management Pty Ltd v FCT illustrates the taxation principle that an expense is deductible in a later year when the event that gave rise to the expense occurred in an earlier year.

In *FCT v Jones* the High Court held that the interest expense on the loan taken out when a business was operational was still deductible even when the business was no longer owned by the taxpayer.

W Nevill and Co Ltd v FCT illustrates the taxation law principle that an expense is still deductible in the current financial year even though it results in a reduction of expenses in future years.

There is no need in tax accounting to match the expense to the benefit derived by the action of the taxpayer which may only occur in a future financial year.

Steele v DCT is an important precedent for holding that expenses may be deductible even though no income is derived at the time the expense is incurred but where, as a result of the expense, the taxpayer may generate income in the future.

Sections 82KZL to 82KZMG regulate the timing of the deductibility of advance expenditure.

These provisions were introduced to prevent a taxpayer claiming a deduction for the prepayment of expenses in a current financial year of, say, five years' worth of expenses.

The two main exceptions are amounts of expenditure, which are specifically excluded from the apportionment rule, and certain payments made by SBE's non-business taxpayers.

Section 82KZL (1) states that the following types of expenditure are excluded from the 12-month prepayment rules:

- Amounts of less than $1000.
- Amounts required to be incurred by a court order or law of the Commonwealth, State or Territory.
- Payments of salary or wages (under a contract of service).
- Amounts that are capital, private or domestic in nature.
- Certain amounts incurred by a general insurance company in connection with the issue of policies or the payment of reinsurance premiums.

SBE taxpayers and non-business taxpayers such as passive investors, are provided with specific treatment in that they can pay for a service up to 12 months and obtain an immediate deduction: s 82KZM.

If the non-business expenditure's eligible service period is more than 12 months or it ends after the last day of the next income year, you must use the following formula to work out your deduction:

Expenditure x (number of days of eligible service period in the income year / total number of days of eligible service period).

PROVISIONS:

The two cases of *FCT v James Flood Pty Ltd* and *Nilsen Development Laboratories Pty Ltd v FCT* relate to the deductibility of provisions for future expenses, such as long service leave and annual leave for employees.

In both cases the High Court held that the provision was not deductible as there was no actual liability at the time of making the provision.

The High Court held that in order for an expense, loss or outgoing to be incurred it does not require the amount to be actually paid, but it does require a liability to meet the payment that is fixed and cannot be changed.

Section 26-10 confirms that a deduction for leave, such as long service leave, annual leave and sick leave, may only be claimed in the year paid:

(1) You cannot deduct under this Act a loss or outgoing for long service leave, annual leave, sick leave or any other leave except:
(a) An amount paid in the income year to the individual to whom the leave relates (or, if that individual has died, to that individual's dependant or legal personal representative).
(b) An accrued leave transfer payment that is made in the income year.

A provision or an allowance for the anticipated expenses is not deductible.

Provisions for bad debts are not allowable deductions. Provisions are usually book entries, for financial accounting purposes, made in respect of anticipated or possible future loss contingencies.

Insurance companies incur liabilities at the time that certain events occur but of which the insurance company may not become aware until sometime in the future.

Commercial Union Assurance v FCT was similar to *RACV Insurances Pty Ltd v FCT* and affirmed the right to be able to claim a deduction based on an estimate of claims likely to be made.

In this case the provision was deductible even though it included an estimate of damages to be paid by policy holders that had not notified the insurance company within the stipulated time limit.