General Principles

Income Tax Assessment Act 1936:

- Cth govt assumed role for collecting income tax from the states to fund the war.
- Legislation drafted by the parliamentary council (attached parliament house)
- Initially simple piece of legislation drafted by several persons
- Expanded over time via amendments (5 x thicker in 1980's)
- Extensive amendments (i.e. s.159ZZZQR) made act unworkable
- 1990's: treasurer sought to simplify act
- 1997: ITAA 1997 enacted to work in parallel w/1936 act until all old provisions rewritten.
- Office of Parlimentary Council drafts legislation.

Income Tax Assessment Act 1997:

- Legislation was to deal with general first and then the more specific scenarios.
- Empty but for core provisions which incorporated provisions from 1936 act by cross reference.
- Over time, cross referencing provisions rewritten resulting in less references to old act
- 2008: Cross referencing halted. Over time, old act expected to disappear,

Constitutional Power of Taxation:

- **s.51 C:** Cth may make laws w.r.t. taxation. Cannot discriminate b/w states or parts of states.
- **s.55 C:** Limitation: Laws imposing taxation should only deal with imposition of taxation and <u>nothing else.</u> Machinery sections should be in another act.
  Reason: To prevent govt tacking on other legislation to tax legislation.
- "Taxing/Rating" acts merely impose rates of taxation. Numbers are calculated in accordance with separate machinery legislation.

Tax System Generally:

- Taxes you on increase in wealth over two points in time
- Doesn't capture unrealised CG; i.e. an asset gaining in value that has not been sold.

Tax Base:

- $ tax is a combination of how taxable income is calculated and the rate.
- The broader the tax base, the lower the rate of tax can be set.
- i.e. Company tax rate has come down yet taxable income increased via CGT laws.
- i.e. GST: broad tax base, 10% rate. If food were included, rate could be 7.5% to achieve same revenue.
- Rate of tax gets publicity, not equally important calculation provisions!

6.5 ordinary income
6.10 stat income
8.1
8.5 specific deductions (listed at 12.5)
8.10 if 2 sections cover a deduction "most appro prevails)
6.25 statutory income prevails

Income Tax Assessment Act 1997

PART 1-1--PRELIMINARY

Division 1--Preliminary

1.1. Short title (1=division .1=section

How to be cited

1.2. Commencement

Date of commencement

1.3. Differences in style not to affect meaning

1-3(1): Act contains provisions of ITAA 1936 in re-written form.
1-3(2): New act is mere re-write of old act. No rules changed. If old act provisions re-written, intended to apply in the same way.

PART 1-2--A GUIDE TO THIS ACT

Division 2--How to use this Act

A guide: explains what the operative provisions are supposed to do.

Subdivision 2-A--How to find your way around

2.1. The design

Act designed to accurately and quickly identify and navigate provisions that apply to the tax payer.

Subdivision 2-B--How the Act is arranged

2.5. The pyramid

- Act arranged in a way to move from the general case to the particular.
- Central (core) provisions at top of pyramid
- General provision in middle of pyramid
- Specialist topics on 3rd level down (i.e. super, international/financial transationct)
- Administration at bottom of period

Subdivision 2-C--How to identify defined terms and find the definitions

2.10. When defined terms are identified

Many of the terms in the act are defined for the purpose of the whole act.

If asterisked (usually on 1st occurrence of the term), see definitions in **995-1.**

2.15. When terms are not identified

Very common terms are not asterisked yet still defined in **995-1.**

Subdivision 2-D--The numbering system

2.25. Purposes

To allow for future expansion of the act; to indicate the relationship b/w purposes at different levels.

2.30. Gaps in the numbering

There are 995 divisions in the tax act, most of which are empty.

Subdivision 2-E--Status of Guides and other non-operative material

2.40. Guides

s.950-150: Provides limited purpose for which guides may be used. Ie:you can use extrinsic material as per the Acts Int Act.
(Similar to s.15 AIA Cth which stipulates what can be used to interpret legislation.)

Guides may be used when actual operative materials are unclear/anomalies in operative materials.

Division 3--What this Act is about

3.5. Annual income tax

Income tax is payable each year by each individual and entity.

PART 1-3--CORE PROVISIONS: Provisions existing @ time of enactment of ITAA 1997.

Division 4--How to work out the income tax payable on your taxable income

4.1. Who must pay income tax

Individuals and entities.

4.5. Meaning of you

Refers to entities generally, so it's easier to comprehend and read the legislation, unless it specifically excludes someone.

(In 1936 Act – referred to as 'the taxpayer.')

WORKING OUT AMOUNT OF INCOME TAX YOU PAY

4.10. How to work out how much income tax you must pay

(1) (ie subsection1) You must pay income tax for each financial year (1st July to 30th June)

***(3): Income Tax = (Taxable Income * Rate) – Tax Offsets (rate set by Income ratings act)

Rate:
- Taxing & Ratings Acts
- Company Income – 30% from first $1
- Individuals – tax free threshold then progressive scale
- Franking rebate

Tax offsets:
- Spouse rebates
- Housing rebates
- Age offsets
- Medical expense rebates
- Low income tax offsets

4.15. How to work out your taxable income

***(1) Taxable Income = Assessable (ordinary + statutory) Income – Deductions.
(revenue – expenses=net profit)

Example:
- Company sells certain goods.
- Assessable income = gross sales; interest.
- Deductions = staff wages, electricity, raw materials.
- Net profit = total revenue – expenses
- Tax act seeks to claim a percentage of this net profit.

Direct vs Indirect Taxation:

Direct Taxes:
- Progressive; i.e. income tax – the richer you are the more you pay.
- Harder and more expensive to collect as everyone has to pay

Indirect taxes: (collected by supplier who is legally liable for it, paid for by consumer)
- Regressive; i.e. GST – rich & poor pay same amount, yet rich may spend more
- Easier to collect due to less avoidance as person who bears burden doesn't pay for it
- Easier to collect as there are less people to collect them from
- Don't concern ability of members of the public to pay the taxes

Income tax vs GST:
- Income tax paid by everyone – burden is borne by taxpayer
- GST paid by the supplier – burden borne by public (added to sale price)
  There is a broader tax base which results in lower taxes.
  Appreciating assets are not taxed- ie: unrealised capital gains.

Concept of Income

Division 6--Assessable income and exempt income

6-1(1): Assessable income consists of ordinary income (not defined) & statutory income.

A. Common Law Concept of Income: - **6-5**

- Covers 95% of income included in ones assessable income.
- No specific section stipulates what must be included in assessable income
- Common law concept of income
- Section merely states that 'income according to ordinary concepts' must be included

*** 6.5. Income according to ordinary concepts (ordinary income)

(1) Your ***assessable income*** includes income according to ordinary concepts, which is called ***ordinary income*** .

(4) In working out whether you have ***derived*** an amount of * ordinary income, and (if so) when you ***derived*** it, you are taken to have received the amountas soon as it is applied or dealt with in any way on your behalf or as you direct

Income: (ordinary definition)

- There is no definition of 'ordinary income' or 'income' in the act not asterisked and also not in 995-1.
- Ordinary English use (dictionary meaning) should be adopted (UK Judicial Decisions)

Basic notions underlining the meaning:

i) The idea of gains from the carrying on of an organised activity
   i.e. employment, business, professional business deal directed towards the making of gains.

ii) The idea of gains derived from property, which leave the property intact.
   A fruit of the tree is distinct from the tree itself.
   i.e. Rent, royalties, intellectual property, interest.

iii) The idea of compensation as a substitute for gains
   i.e. if you are compensated for loss of income

iv) A characteristic of income is often that it is received periodically
   i.e. salary, income, wages.

(3 types of income- personal/property/business and then statutory (CGT))

****

<u>Income must be cash or convertible to cash:</u> (CL Concept)

Tennant v Smith (1892): Ordinary income must be cash or convertible to cash

Facts:

- Arrangement between employer and employee
- Bank manager provided with rent free accommodation by the bank
- Terms: manager couldn't assign lease or sublet premises – non-convertible benefit
- Was he assessable on the value of the benefit?

Held:

- Not assessable Ordinary income requires receipt be either in the form of money or convertible into money.
- The mere fact that a receipt saves you money, doesn't mean it's an expenditure of the income.

FCT v Cooke and Sherden (1980): Not ordinary income if not convertible

Facts:

- Husband and wife ran family business – selling cordial around suburbs
- Manufacturer of cordial provided volume rebate Singapore holiday (non-transferable and non-convertible) to highest cordial supplier purchase in a month.
- Is value of holidays included in couple's ordinary income?

Held (FCA):

- Tennant v Smith referred to – receipt had all indicia of ordinary income but isn't.
- Holiday was really a volume rebate; i.e. buy a certain amount of product off the supplier and get a rebate.
- Rebate cannot be converted to cash hence is not ordinary income.

Ratio:

- Where something is not convertible to cash, it cannot be treated as ordinary income.

**s.21A – ITAA 1936: Non-cash business benefits

(1) For the purposes of this Act, in determining the income derived by a taxpayer, a non-cash business benefit that is not convertible to cash shall be treated as if it were convertible to cash.

(2) For the purposes of this Act, if a non-cash business benefit (whether or not convertible to cash) is income derived by a taxpayer:

(a) the benefit shall be brought into account at its arm's length value reduced by the recipient's contribution (if any); and

(b) if the benefit is not convertible to cash--in determining the arm's length value of the benefit, any conditions that would prevent or restrict the conversion of the benefit to cash shall be disregarded.

Ratio: Receipt that is not convertible is treated as if it was convertible!!!!

B. STATUTORY INCOME

6.10. Other assessable income (statutory income)

(1) Assessable income includes some amounts that are not ordinary income listed in **10-5.**

(2) These amounts are called 'statutory income.'

(3) Equivalent to **6-5(4):** If an amount would be statutory income apart from the fact that you have not received it, it becomes statutory income as soon as it is applied or dealt with in any way on your behalf or as you direct.

***s. 10-5:** List of provisions about assessable income

- Alphabetical listing of statutory income provisions.
- Refers to 1936 act in some circumstances; i.e. annuities

Reasons for Provisions in 10-5:

(i) Court ruling read down meaning of ordinary income and government wants certain receipt taxed nonetheless.

(ii) Receipt is ordinary income, but it is unclear about how much of the amount if income and when it should be included in taxpayers assessment.
i.e. Currency exchanges by banks – 6-5 cannot deal with these as they are very complicated. Specific provisions state how these are taxed

(iii) Receipts that weren't income but government has decided to tax them to broaden the tax base; i.e. capital gains.

6.15. What is not assessable income

(1) Amounts not ordinary or statutory income are not assessable – not tax to pay on these.

Priorities b/w Ordinary & Statutory Income

6.25. Relationships among various rules about ordinary income

***Unless there is a contrary intention, statutory income prevails.

(1) Where ordinary income is included in statutory income sections (and vice versa), you only have to pay tax on it once no double taxing where more than one provision applies.

(2) Where both a statutory income section applies and the receipt is also ordinary income, the statutory income rule will apply but for a contrary intention.

Residence and Jurisdictional Provisions

Individuals

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.

(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.

Note: Mirrored statutory income provisions in **6-10(4)/6-10(5)**

6-5(2): Australian resident is taxed on Australian and worldwide sourced income, both directly and indirectly.

6-5(3): Foreign resident taxed on income derived directly or indirectly from Australian sources. (ie- ordinary income but only stat income from Aust sources)

Example: US citizen owns rental property in AU – subject to tax in Australia. AU citizen owns rental property in US – subject to tax in AU and US, but AU govt gives credit.

995-1: Australian Resident

- If taxpayer isn't Australian resident as per definition, taxpayer is a foreign resident.
- No asterisk in 6-5 beside 'Australian resident' or 'Foreign resident' yet still defined as it is a common term **(2-15)**
- ***Australian resident*** means a person who is a *resident of Australia* for the purposes of the *Income Tax Assessment Act 1936*.

s.6(1) ITAA 1936: A person will be a resident of Australia if:

Test 1: A person, other than a company resides in Australia,

Test 2: Includes a person whose domicile is in Australia unless the commissioner is satisfied that the person has established a permanent place of abode outside Australia.

Test 3: Where the person has been in Australia continuously or intermittently for more than one half of the year of income unless the commissioner is satisfied that the person's usual place of abode is outside Australia and the person does not intend to take up residence in Australia.

If the person is not caught by any one of the 3 tests, they are taken to be a foreign resident.

Test 1: Reside in Australia **s.6(1)(a) 1936 Act**

There is no definition of reside so Oxford dictionary meaning is taken:
- To dwell for considerable time
- To have one usual abode
- To live in or at a particular place.

Reside requires more than a mere presence in the jurisdiction, however less than permanent.

Factors to be taken into account to determine whether someone resides:
- Time physically spent in a place
- Where they earn their living
- Where they socialize
- Where their family lives
- Where they maintain a home.

Gregory v DFCT (1937): Business in two places. Resided in two places.
Facts:
- G carrying on pearl fishing business in his home in Broome (WA).
- G set up fishing fleet in Darwin & rented a portion of a house there.
- G spent some time in Broome running pearl business and some time in Darwin running fishing business whilst living in the rented house.
- G did most of his socialising in Darwin.
- States imposed income taxes @ time of case.
- Residence related to where G must pay tax. Where did G reside?

Held:
- G resided in both WA and NT.
- G hadn't ceased residing in Broome but had also commenced residing in Darwin.

IRC v Lysaght (1936): Circumstances are such that person resides somewhere
Facts:
- L lived in England & ran a business. L sold his home & moved with family to Ireland.
- L stayed with family in Ireland.
- Travelled to England once/month for business, staying in a hotel whilst there.
- IRC claimed L resided in England. L appealed to HOL on error of law.

HOL Held:
- IRC's decision affirmed.
- "A man might well be compelled to reside here often against his will. The necessities of business compel him."

Ratio:
- If necessities of business and conditions under which you stay turn out as such, L is said to still reside in England despite him only being their ¼ weeks per month.
- Where someone resides is descriptive of the person, not their property.

E.g. Schapelle Corby arrested in Bali for drugs. Family and home are in Australia. Circumstances are such that she resides in Bali.

Test 2: Domicile Test **s.6(1)(a)(i) 1936 Act**

- Domicile is not defined in the act.

- Basically means taxpayers 'place of birth'; i.e. domicile of origin.
- Domicile can be changed during lifetime by immigration; i.e. domicile of choice.
- Taxpayer must have intention to fix permanently to another place.
- i.e. Born in Italy, lifelong DOB is Italy, unless T/P immigrates permanently to AUS

Australian Locals: If person born in Australia, they are a resident automatically unless FCT is satisfied that person has established a permanent place of abode outside Australia.

Meaning of permanent:
- If construed as meaning forever – must satisfy FCT of this.
- Issue: On this interpretation, if you're moved forever you're not domiciled in Australia – but this section assumes you're domiciled in Australia.

FCT v Applegate (1979): Permanent doesn't mean everlasting.
Facts:
- A worked in Sydney law firm on 1/7/71.
- A left AU in Nov 71 to set up branch office of Law firm in Vanuatu.
- A gave up Syd rental agreement, took up long term lease on house w/wife in Vanuatu.
- Wife returned to AU in Dec 71 to have a child.
- A visited wife in AU and took her back to Vanuatu.
- A returned to AU in Jul 72 after he became ill.
- Was A a resident of Australia for purpose of financial year ending 30/6/72?

Note:
- One cannot be a resident for part of a year.
- Income is sourced where the work is performed; i.e. If A is a foreign resident, whilst FCT can clearly get tax on A's work in Australia, but FCT also wanted to tax A when he went to Vanuatu.
- FCT can only get o/s tax if established that A was Australian resident for whole financial year.
- A could avoid tax is satisfies FCT he had established permanent place of abode outside Australia.

Held FCA:
- A was born in Australia so he is domiciled in Australia.
- Question was whether A had established a permanent place of abode o/s Australia?
- Permanent has to be read not as everlasting.
- Section must be construed in context of particular income year.
- A had established PPOA outside Australia – kids went to school, he worked and settled in Vanuatu.

FCT v Jenkins (1982):
Facts: Same facts as Applegate. J was a bank officer, moved to Vanuatu to set up branch.
Difference: A was set up for indefinite period. J was sent to definite period of 3 years but returned early due to falling ill.
Held:
- Same result a definite period only need be established.
- For that particular period, J established a permanent place of abode outside Australia.

<u>Test 3: Presence of more than half income year</u>