INTRODUCTION

Types of taxes

A tax is a contribution levied on a person, property or business for the support of the government.

Direct

Direct taxes cannot be passed on (personal income tax, company tax, capital gains).

Progressive

Progressive taxes take an increasing proportion of income as income rises.

Proportional

Otherwise known as a flat tax, a proportional tax is opposite to a progressive tax. It is cheaper to administer than a progressive system, therefore more money can be spent by the government.

Indirect

An indirect tax is generally regressive and are known as consumption taxes. They are levied on the supply of goods or services rather than directly on income (GST).

Regressive

Regressive taxes hit the poorest people the hardest. The rate increases as the value of the goods or services increases.

When do we pay tax?

We pay tax every time we purchase something (GST), every financial year (Income Tax) and by employers (Fringe Benefits Tax).

Why do we pay tax?

We pay tax for community services, to achieve government objectives and for social engineering (modifying private behaviour – cigarette tax).

Why do we have two assessment acts?

The Tax Law Improvement Project (TLIP) tried to re-write the 1936 act because it was out of date and overcomplicated. It wasn't about reforming the system as a whole. TLIP was overtaken by reform, therefore, both acts exist concurrently.

Section 1-3 ITAA97

This section provides that the difference in writing style (clearer and simpler) between the two acts does not mean that the ideas are different.

Why are tax rates in a separate act?

Section 55 of the Constitution requires that an act dealing with the imposition of taxes deals with that subject alone. Therefore, they couldn't include it in the administrative acts because that is a separate subject matter.

Key Concepts

Income

Found in 6-5 ITAA97, Income is receipts that we pay tax on.

Deductions

Found in 8-1 ITAA97, Deductions are expenses which reduce the tax we pay.

Capital

Found in Part 3-1 ITAA97, Capital are receipts that are statutory income.

Income Tax

Found in 995-1 ITAA97, Income Tax is tax imposed in any of the listed acts.

4-10 ITAA97

You pay tax on your taxable income of each financial year. Section 4-10(3) states you calculate your income tax by the following formula: $Income\ Tax = (Taxable\ Income \times Rate) - Tax\ Offsets$

4-15 ITAA97

You calculate the taxable income by the following formula: $Taxable\ Income = Assessable\ Income - Deductions$

Financial Year

Found in 4-10 ITAA97, the Financial Year is the year ending 30th June.

Income Year

Found in 4-10 ITAA97, the Income Year is the same as the financial year unless you are a company.

Assessable Income

Ordinary Income

Found in s6-5 ITAA97, Ordinary Income is income according to ordinary concepts.

Statutory Income

Found in 6-10 ITAA97, Statutory Income is not ordinary income but amounts deemed to be income by an ITAA.

Exempt Income

Found in 6-20 ITAA97, Exempt income is income that is expressly or implicitly made exempt.

Allowable Deductions

Found in 8-1&5 ITAA97 but defined in 995-1, a deduction is an amount you can deduct and is further defined in 8-1 and 8-5.

RESIDENCE

6-5(2) ITAA97

If you are a resident, your assessable income includes ordinary income from all sources.

6-5(3) ITAA97

If you are a non-resident, your assessable income includes ordinary income from Australian sources.

Definition of Resident

995-1 ITAA97 to 6(5) ITAA36

This contains the three statutory tests of residence.

Tests (s 6(1) ITAA36)

Common Law Test [EITHER]

Definition of Reside

The Oxford English Dictionary definition of reside is to 'dwell permanently or for a considerable period of time, settle or usual place of abode'. This is a question of fact and degree, not law, where a number of factors are weighed up, but no factor is decisive.

<u>Levene v IRC</u>

Facts: He lived in London his whole life, left on medical advice, surrendered property lease, sold furniture, lived in overseas hotels for 7 months and in London for 5. Six years later, he took a 9 year lease on a flat in Monte Carlo.

Rule: He only lost UK residence when he took out the lease. You can reside in more than one place. His strong ties, physical presence and nationality were decisive factors.

<u>TR 98/17</u>

If you intended to visit for less than 6 months, you would not be residing in Australia

<u>Lysaght v IRC</u>

Facts: English man who retired to Ireland, went back to England for 1 week a month to consult, he only stayed in hotels, bank accounts in both countries, he was trying to sell his English property.

Rule: Residence is a question of fact and degree, not law, so even though he had a home in Ireland, he was a UK resident. Frequency of visits was the key factor.

<u>Cooper v Cadwalader</u>

Facts: US Barrister had a property in Scotland that he only spent 2 months of a year in, but it was always occupied by two servants who kept it ready for him to come to at any time.

Rule: UK resident because it was always waiting for him.

Factors

- Physical presence in Australia
- Frequency, regularity, purpose and duration of visits
- Maintenance of a home in Australia
- Family and business ties in a particular country
- Present habits and way of life
- Nationality

Domicile [R → NR]

Definition of Domicile

Domicile comprises physical residence and an intention to remain permanently and indefinitely in the place of residence.

Person has domicile in Australia

It can either be by origin (acquire at birth) or by choice (person acts and intends to choose a new jurisdiction as their permanent place of abode). But you cannot have more than one.

Does not have a permanent place of abode outside Australia

Applegate v FCT

Facts: Sydney solicitor went to Vila, gave up flat and assets, had hospital cover and life insurance in Australia, had not set a time to come back to Australia, rented in Vila with wife, holidayed in Australia, wife gave birth in Vila but returned because she was ill.

Rule: Permanent does not mean forever. Permanent takes meaning from context and reference to domicile, needs to mean less than everlasting but more than temporary

Jenkins v FCT

Facts: Bank officer went to Vila for a set time of three years, he couldn't sell his home so he rented it, furniture was stored and returned after 18 months because of illness.

Rule: You can have a permanent place of abode even if your intention is to return at a specified time. Three years was significant so it was permanent.

IT 2650

If more than 2 years, generally will have permanent place of abode outside Australia. If less than 2 years, generally only a transitory period.

Factors

- Intention as to length of stay
- Actual length of stay
- Abandonment of place of abode in Australia
- Acquisition of place of abode outside Australia
- Intention to make place of abode 'home'
- Nature and quality of use made of place of abode
- Duration and continuity of presence in place
- Durability of association with place

183 Day Rule [NR → R]

Elements

Must be in Australia for 183 days; UNLESS

This period may be continuous or intermittent.

Usual place of abode is outside Australia; and

This is something less than permanent.

Does not intend to take up residence

Superannuation

Only applicable to an eligible employee under the Superannuation Act 1976. Therefore, only embassy staff

Temporary Resident (find section)

You are a temporary resident if you hold a temporary visa, and you are not an Australian resident under the Social Security Act 1991, and your spouse is not an Australian resident under the same act. However, you cannot be a temporary resident if you have been an Australia resident under this act.

Tax emption for residents who are…

768-910 ITAA97

All ordinary and statutory income derived from a foreign source is exempt.

768-915 ITAA97

Capital gains and capital losses made on assets that are not taxable Australian property are exempt.

768-980 ITAA 97

Interest withholding obligations associated with amounts owing to foreign lenders are exempt.

SOURCE

Ordinary Income

6-5(2) ITAA97

If you are a resident, your assessable income includes ordinary income from all sources.

6-5(3) ITAA97

If you are a non-resident, your assessable income includes ordinary income from Australian sources.

Statutory Income

6-10(4) ITAA97

If you are a resident, your assessable income includes statutory income from all sources.

6-10(5) ITAA97

If you are a non-resident, your assessable income includes statutory income from Australian sources.

Definition

995-1 ITAA97

Australian source income is ordinary or statutory income derived from a source in Australia

Nathan v FCT

Source is what a practical man would regard as a real source of income. But the ascertainment of the actual source of a given income is a practical, hard matter of fact.

TR 2013/1

Take a substance over form approach to the rule of Nathan.

Test

Is it income?

If so, what type of income is it?

Remuneration for services rendered

Cam and Sons

Facts: Men employed on trawlers, employment was entered into in NSW, some work was performed outside NSW, payment was made in NSW.

Rule: Wages were apportioned. Consider the contract (place it was entered into), the performance (the place where it was performed), and payment (the place where payment was made). The source is generally where you perform it.

FCT v French

Facts: Taxpayer sent for 2-3 weeks to NZ, he claimed the money earned in NZ was from an overseas source

Rule: Source in NZ, where personal exertion took place

FCT v Mitchum

Facts: Taxpayer was a non-resident actor, was in Australia for 11 weeks to act and provide consultancy services to a film partially made in Australia. Contract entered into overseas, payment made overseas.

Rule: Not derived from Australian sources, ask if it just the performance that is important, or are there other factors more important. If creative powers or special knowledge is involved so that the place of performance is relatively unimportant, the dominant source will be where the contract is made.

Evans v FCT

Facts: Academic who was on sabbatical in Switzerland, but salary paid to Australian bank account.

Rule: Although he was overseas, it was Australian sourced, because he could do that work anywhere.

Financial Transactions

Financial Transactions are a question of fact and will generally be sourced where services of the company are performed.

Thorpe Nominees v FCT

Facts: They shifted income offshore to minimize tax, but it was tax avoidance.

Rule: Look at the chief factor to determine source. Because the whole scheme was arranged in Australia by Australians to Australians, the source was Australian.

Business Income

Look at the type of business carried on and where the business is. However, there is no case directly on this. Rhodesia is on the sale of real estate and really the closest we can get.

Rhodesia Metals v C of T

Facts: Taxpayer was in business of purchasing mining claims, purchased some in Rhodesia, contracts made in England, and sold claims by entering contracts in England

Rule: The location of the property determines the source.

Interest

You need to consider the place of contract and where the money was lent.

FCT v Spotless Services

Facts: Interest paid to an Australian company by a Cook Islands Bank on funds deposited against a certificate of deposit issued by that bank.

Rule: The place where the contract was made and where the money was lent are the important factors.

Dividends

Section 44(1) ITAA36

Source is determined by the source of the profits out of which the dividend has been paid. It is also a question of fact in each case.

Esquire Nominees v FCT

Facts: Esquire (Norfolk Island company) received dividends from another Norfolk Island company which came from an Australian company.

Rule: It was a foreign source. The source of the profits of the company that paid the dividends was the source (middle company). It is not the location of the share register but the company paying the dividend made the profit.

Capital Gains

If after 12 December 2006, source is determined whether the asset is taxable Australian property. If before 12 December 2006, the asset must just have a necessary connection with Australia.

Apply the source rules that apply to that specific type of income.

DERIVATION

6-5(2) ITAA97

Assessable income includes ordinary income that is derived during the income year.

6-5(4) ITAA97

You have received an amount as soon as it is applied/dealt with on your behalf.

Methods

There is only one correct method applicable to each taxpayer and it is a question of fact.

Cash basis

Under this method, income is derived when it is **received**.

Accruals Basis

Under this method, income is derived when it is **earned**.

For business

J Rowe & Son v FCT

The income of a business is derived when it is earned.

For individuals

Employees

If it is mostly due to the employee, then **accrual**.

Trading Stock

If sale is only incidental, then **cash**. If trading stock is really important, then **accrual**.

Cash or credit sales

If extend credit sales to a large number of customers, then **accrual.**

Capital equipment

If profits are primarily attributable to the exploitation of capital, then **accrual**. If it is more skill, then **cash**.

Reliance on circulating capital or consumables

If relying on those directly to derive income, then **accrual**.

Carden's case

Facts: Taxpayer was an executor of estate, prior to death Dr Carden was using the cash basis, this would mean his outstanding debts weren't taxed, so the correct method of accounting was determined with business and commercial principles.

Rule: Use cash basis. Where there is stock on hand, **accrual**. Where the receipts are a reward for professional skill, **cash**.

Brent v FC of T

Facts: Taxpayer sold her life story for $62,250 but only received $10,000

Rule: Cash basis, because there was no business, profession, or stock in trade, it was a reward for personal services.

Henderson v FC of T

Facts: Largest accountancy firm in WA (295 employees), had fees of over $1 million, and $98 in bad debts, the firm changed from cash to accrual.

Rule: Accrual. Although this was a business run on personal service, the size, structure and method of operation of the business meant that it should now be accrual.

FCT v Firstenberg

Facts: A sole practitioner had one employee and operated on the cash basis

Rule: Cash because of the differences with Henderson.

FCT v Dunn

Facts: A sole practitioner had a few employees that were mostly family, but he was the only qualified accountant.

Rule: Cash by following Firstenberg and differentiating the facts of Henderson.

Barratt v FC of T

Facts: Partners in a pathology practice had many staff that were well qualified and generated large amounts of income apart from the partners

Rule: Accrual because it aligns more closely with Henderson

Payments received in advance

Arthur Murray v FC of T

Facts: Taxpayer ran dance lessons and received payments in advance with no refund policy. This only became income when it was earned (class was run)

Rule: Pre-paid tuition fees were derived in the year that the tuition was provided.