**UNIT 1 - OVERVIEW OF THE AUSTRALIAN TAXATION SYSTEM**

### INCOME

<table>
<thead>
<tr>
<th>(s4-10(3)) INCOME TAX</th>
<th>=</th>
<th>(TAXABLE INCOME x TAX RATE) - OFFSETS</th>
<th>(s 13-1)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>(s4-15) TAXABLE INCOME</th>
<th>=</th>
<th>ASSESSABLE INCOME - DEDUCTIONS</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>(s36-10) TAX LOSS</th>
<th>=</th>
<th>DEDUCTIONS - ASSESSABLE INCOME - NET EXEMPT INCOME</th>
</tr>
</thead>
</table>

### ASSESSABLE INCOME

- **ORDINARY INCOME**
  - Ordinary Income
  - Statutory Income

- **STATUTORY INCOME**
  - Amounts that are not Ordinary Income but ARE ASSESSABLE by other provisions
  - Includes:
    - A Scheme that has the intention of MAKING A PROFIT see CLP U1 P 26
    - Royalties
    - Disposal of Leased car for a profit CLP U1 P 27
    - Definition of car
    - The Lower of: The notional depreciation:

### DERIVATION OF INCOME:

- Cash
- Interest
- Individual investor
- Overdue accounts
- Ordinary business
- Trading income
- Dividends
- Rent
- Professional services
- Long-term construction

### STATUTORY INCOME:

- Amounts that are not Ordinary Income but ARE ASSESSABLE by other provisions
  - Includes:
    - A Scheme that has the intention of MAKING A PROFIT see CLP U1 P 26
    - Royalties
    - Disposal of Leased car for a profit CLP U1 P 27
  - Definition of car
  - The Lower of: The notional depreciation:

- (Lessors original cost - Lessors termination value) x number of days in lease period
- The deductible lease charges
- The actual profit made
- Interest on overpayments of Tax
- ETP's - Eligible Termination Payments
- Excess of Closing Stock over Opening Stock
- Dividends
- Partnership Distributions
- Trust Distributions
- Deemed Dividends from Private Companies
- Net Capital Gains
- Sale of work-in-progress (WIP) amounts CLP U1 P 28
- Reimbursed car expense
- Gain on disposal of depreciating asset
- Employee share scheme
- Supperanuation benefits
- Foreign exchange gains
**EXEMPT INCOME**

Ordinary or statutory income that is specifically excluded from assessable income, s.6-20

Includes:
- income of entities that are exempt no matter what type of income it is, s.11-5
- income which is exempt no matter who receives it, s.11-15
- income which is exempt only if it is derived by certain entities

**FOREIGN SOURCE INCOME FOR NON-RESIDENTS**

s.6-5(3), s.6-10(5) ITAA 1997
s.23(r) ITAA 1936

**INCOME EARNED IN OVERSEAS EMPLOYMENT**

s.23AG ITAA 1936

**BRANCH PROFITS OF AUSTRALIAN COMPANIES**

s.23AH ITAA 1936

**FRINGE BENEFITS**

s.23L(1) ITAA 1936
s.23AF ITAA 1936
s.23L(2) ITAA 1936

**Non-Assessable Non Exempt Income**

Income does NOT reduce TAX LOSSES (in the way exempt income does), s.6-23

- Fringe Benefits, s.23L(1) ITAA 1936
- A non-portfolio return paid by a foreign company to AUS resident company that holds >10% s.768-5 ITAA 1997
- GST payable on a taxable supply, s.17-5(a) ITAA 1997

**CAPITAL RECEIPTS ARE NOT INCOME:**

Receipt more likely to be capital if:
- Gain relating to one-off event (Californian Oil Products Limited v FCT)
- Amount received for a restrictive convenant (Dickenson v FCT)
- Gain resulting from merely realising an investment (Scottish Australie Mining Co Limited v FCT)
- Contrast: view to making a profit (FCT v Whalfords Beach Pty Ltd)
- Transaction occurring outside of ordinary course of business and not entered with intention of making profit (Westfield Limited v FCT)
- Lump sum (McLaurin v FCT)

**CASH vs ACCRUALS:**

**ACCRUALS** based on when income is ‘earned’
- Income not derived even if income is received in advance (Arthur Murray (NSW) P/L v FCT); (Country Magazine P/L v FCT)

**CASH** based on ‘receipt of income’
- can be directed by that person ss6-5(4) and 6-10(3)

**Note:**
- Trading Organisations must use accruals method for that income (J Rowe and Sons Pty Ltd v FCT)
- Business taxpayer use ACCRUALS BASIS where: TR 93/11
- Account ing practice uses accruals (Carden’s Case)
- Business incorporated
- Business infrastructure devices the income
- Sole Practitioners can be assessed using CASH BASIS (Firstenberg v FCT); (FCT v Dunn) IT 2503
- Large Accounting firms should use ACCRUALS BASIS (Henderson v FCT)
- In moving from Cash to Accruals, Debtors in last Cash year escape tax (Henderson v FCT)
- Debtors could be caputred by CGT ATO ID 2008/110
- WIP not included in assessable income (Henderson v FCT); TR 93/11

**NON-CASH BUSINESS BENEFITS**

s.21A(1) ITAA 1936 treat any non-cash business benefit that is not covertible to cash as if it was covertible to cash

- only applies to business relationships s.21A(5) ITAA 1936
- value is arm’s length value less any recipient contribution s.21A(2) ITAA 1936
- reduced by portion that would be deductable s.21A(3) and (4) ITAA 1936
- Exemption of $300 s.21(1) ITAA 1936
**RESIDENCY**

<table>
<thead>
<tr>
<th></th>
<th>Resident (ss 6-5(2), 6-10(4))</th>
<th>Foreign Resident (ss 6-5(3), 6-10(5))</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessable Income</td>
<td>All sources (worldwide)</td>
<td>Australian Income only</td>
</tr>
<tr>
<td>Tax-free Threshold</td>
<td>$6,000</td>
<td>NIL</td>
</tr>
<tr>
<td>Marginal Rate</td>
<td>Lower</td>
<td>Higher</td>
</tr>
<tr>
<td>Medicare Levy</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Dividends, Interest &amp; Royalties</td>
<td>Not Subject to W/Holding Tax</td>
<td>Subject to W/Holding Tax</td>
</tr>
<tr>
<td>CGT on disposal of asset</td>
<td>All assets (worldwide)</td>
<td>Australian Assets only</td>
</tr>
</tbody>
</table>

**RESIDENCY TESTS FOR INDIVIDUALS s.6(1)(a) ITAA 1936:**

1.) **RESIDES TEST**

   Residency is a question of fact and not law (FCT v Miller). Key factors to consider to support your argument:

   - Intention or purpose of visit: TR 98/17
   - History, frequency, regularity and duration of visits: TR 98/17 (FCT v Pechey)
   - Family and business/employment ties: TR 98/17 (IRC v Lysaght)
   - Social and living arrangements: TR 98/17 (Levene v IRC)
   - Maintenance & Location of Assets: TR 98/17

   If one of the above is SATISFIED this indicates an AUSTRALIAN RESIDENT. If individual satisfies this test other test do not apply (FCT v Applegate)

2.) **DOMICILE TEST**

   A resident is a person whose DOMICILE is in Australia. ("Domicile" can be defined as: "The permanent residence of a person; a place to which even if he or she were temporary absent, they intend to return. In law, it is said that a person may have many residences but only one domicile")

   **PERMANENT PLACE OF ABODE**
   - The INTENDED and ACTUAL duration of the taxpayer's stay overseas: FCT v Applegate IT 2650
   - Whether the taxpayer intends to return to Australia at some DEFINITE point in time: FCT v Applegate IT 2650
   - Whether the taxpayer has an ESTABLISHED HOME outside Australia: FCT v Applegate IT 2650

3.) **183-DAY TEST s.6(1)(a)(ii)**

   The Commissioner deems any person who has physically been in Australia for more than HALF OF THE INCOME YEAR as a resident for taxation purposes for the ENTIRE INCOME YEAR.

4.) **SUPERANNUATION FUND TEST s.6(1)**

   A person is a resident if they are a MEMBER of a SUPERANNUATION SCHEME for COMMONWEALTH GOV'T OFFICIALS. OR a spouse or child of such a person

**RESIDENCY TEST FOR COMPANIES s.6(1)(b) ITAA 1936:**

A company is a resident where it is:

1.) Incorporated in Australia; OR
2.) Not incorporated but CARRIES ON BUSINESS in Australia; AND either:
   a.) CENTRAL MANAGEMENT & CONTROL/OPERATIONS is in Australia; OR
   b.) VOTING POWER is controlled by Australian shareholders/residents

   Conflicting case - as above says Carries on a Business "AND"… TR 2004/15 vMalayan Shipping Co v FCT

**RESIDENCY TEST FOR OTHER:**

- Trust depends on: residence of trustee or central management and control ss 95(2) and (3) ITAA 1936
- "Australian superannuation fund" s295-95(2)

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1. Residency & Source
## SOURCE OF INCOME:

<table>
<thead>
<tr>
<th>Source of Income</th>
<th>Place of Contract/Work/Money Made/Profits Source</th>
<th>Relevant Case(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale of Goods</td>
<td>Place where contract was entered in</td>
<td>CoT (NSW) v Kirk</td>
</tr>
<tr>
<td>Sale of Shares</td>
<td>Place where sale contract entered into (but other factors)</td>
<td>Australian Machinery &amp; Investment Co. v DFCT; TD 2011/24</td>
</tr>
<tr>
<td>Services</td>
<td>Where work is performed. Except specialised/performed anywhere:</td>
<td>FCT v Efstathakis and FCT v French</td>
</tr>
<tr>
<td></td>
<td>1. Service contract entered into</td>
<td>FCT v Mitchum</td>
</tr>
<tr>
<td></td>
<td>2. Payment for services made</td>
<td>Evans v FCT</td>
</tr>
<tr>
<td>Dividend Income</td>
<td>Source is where profits were made which the dividend is paid</td>
<td>Esquire Nominees v FCT</td>
</tr>
<tr>
<td></td>
<td>Australia Residents include Dividends from ALL sources</td>
<td>s.44(1)(a) ITAA 1936</td>
</tr>
<tr>
<td></td>
<td>Non-Residents include Dividends derived from Aust sources only</td>
<td>s.44(1)(b) ITAA 1936</td>
</tr>
<tr>
<td>Interest Income</td>
<td>Source is where funds are advanced</td>
<td>Spotless Services v FCT</td>
</tr>
<tr>
<td></td>
<td>Interest deemed to be sourced in Australia if secured over property in Australia</td>
<td>s.25(2) ITAA 1996</td>
</tr>
<tr>
<td>Rent from Property</td>
<td>Sourced where real property is located</td>
<td>Rhodesia Metals Ltd v C of T</td>
</tr>
<tr>
<td>Royalties</td>
<td>Sourced where property is located</td>
<td>United Aircraft v FCT</td>
</tr>
<tr>
<td></td>
<td>If arising from intellectual property, then where contract is made or where the know-how was provided</td>
<td>United Aircraft v FCT</td>
</tr>
<tr>
<td></td>
<td>Australian business paying royalties = sourced in Australia</td>
<td>s 6C ITAA 1936</td>
</tr>
</tbody>
</table>

## FOREIGN CURRENCY TRANSLATION RULES

The Australian Tax Liability for the taxpayer is required to be expressed & calculated in AU dollars

- s.960-50

This includes amounts that are on revenue or capital account, or otherwise

- s.960-50(3)

Timing of the conversion/translation rules

- s.960-50(6)
### Income Tax

\[
\text{INCOME TAX} = (\text{TAXABLE INCOME} \times \text{TAX RATE}) - \text{OFFSETS}
\]

\[(s13-1)\]

### Taxable Income

\[
\text{TAXABLE INCOME} = \text{ASSESSABLE INCOME} - \text{DEDUCTIONS}
\]

\[(s12-5)\]

### Deductions

Division 8 of ITAA 1997 deals with deductions and contains 3 sections:

- **8-1 GENERAL DEDUCTIONS**
- **8-5 SPECIFIC DEDUCTIONS** see s. 12-5 for a LIST of SPECIFIC DEDUCTIONS
- **8-10 ANTI-DUPLICATE COUNTING RULES** (Where multiple provisions allow dedn, the MOST APPROPRIATE applies)

#### 8.8-1 GENERAL DEDUCTIONS

Provides that a loss or an outgoing is allowed as a deduction to the extent that it is:

- **8-1(1) POSITIVE LIMBS (Must be either):**
  - Incurred in gaining or producing your Assessable Income
  - Necessarily incurred in carrying on a business for the purposes of gaining or producing assessable income

- **8-1(2) NEGATIVE LIMBS (Cannot be any of the following):**
  - Outgoing is CAPITAL in nature
  - Outgoing is of PRIVATE or DOMESTIC nature (only relevant to individuals)
  - Outgoing is incurred in producing EXEMPT income (i.e. prevent competition)
  - Outgoing is prevented by a provision of the ITAA

#### Deductions Flowchart

- If there is a Loss or Outgoing?
  - YES
  - NO

- If it INCURRED in the current year?
  - YES
  - NO

- Does it satisfy one of the POSITIVE LIMBS?
  - Incurred in producing Assessable Income
  - Incurred in carrying on a business for the purposes of producing assessable income
  - YES
  - NO

- Is it caught by ANY of the NEGATIVE LIMBS?
  - Outgoing is CAPITAL in nature
  - Outgoing is of PRIVATE or DOMESTIC nature
  - Outgoing is incurred in producing EXEMPT income
  - Outgoing is prevented by a provision of the ITAA
  - YES
  - NO

- Does the Expenditure only PARTLY relate to the Positive or Negative Limb?
  - YES
  - NO

expense will be APORTIONED and deduction claimed accordingly

#### Incurred (TR 97/7)

- Taxpayer must be DEFINITELY COMMITTED or COMPLETELY SUBJECTED to pay
- INSURER PROVISIONS are DEDUCTIBLE, Must be accurate estimate & likely to occur
- ACTUAL PAYMENT indicates it has been INCURRED
- EXISTING LIABILITY to pay sum of money
- REASONABLY ESTIMATED
- Dispute over liability NOT INCURRED

#### Interest

- 1. Use test - funds used for income producing
- 2. Purpose
- Outgoing must be APPORTIONED were incurred for different purposes
- Possible to allow a deduction for a portion of expenditure used for mixed purposes
- APPORTIONMENT may be required where outgoing relates to more than one year
- PROVISIONS are not generally INCURRED until paid i.e. LSIL or Sick/annual leave

#### Positive Limbs s 8-1

- Expenses related to CGT are not tax deductible
- Carrying on business indicators
  - TR 97/11
  - Size, scale and permanency
  - Cannot be described as hobby, recreation or sporting activity
  - For business deduction is one of commercial necessity rather than legal necessity
  - Deduction to reduce further expenses allowable
  - Can be both employee and carrying on business
  - Expenses incurred prior to starting producing income unlikely to be deductible

#### Negative Limbs

- Expenses incurred after can be deductible

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1. Deductions
EMPLOYEE DEDUCTIONS FOR EMPLOYEES

Professional Fees: Deductible | ss.8-1
Employment Agreements: Deductible | TR 2000/5
Telephone - Business: Deductible | s.8-1
Interest on Loan for Investment Property: Deductible | ss.8-1 Must be NEXUS with gain or prod income (Anovoy v FCT)
Business related professional subscriptions: Deductible | s.8-1
Protective or occupation specific Clothing: Deductible | s.8-1
Home Office Expenses: Deductible | TR 93/20
Self Education Expenses: Deductible | s.8-1 and TR 889
Sunscreen: Deductible | Morris & Ors v FCT - Must be outdoors workers
Club Subscriptions: Not Deductible | s.26-45
Gym Membership: Not Deductible | Private in nature
Newspapers: Not Deductible | Private in nature
Telephone - Personal: Not Deductible | Private in nature - Lunney v FCT
Travel to and from work: Not Deductible | Private in nature
Contributions to Superfund: Not Deductible | s.82A ITAA 1936
Entertainment Expenditure: Not Deductible | s.32-5 (FBT exemption available s.32-20)
Child Care: Not Deductible | Private in nature

s.8-5 SPECIFIC DEDUCTIONS

Tax related Expenditure: 100% deductible in year incurred | s.25-5 ITAA 1997
Lease Documents: 100% deductible in year incurred | s.25-20 ITAA 1997
Borrowing Exp: note if div 230 arrangement | s.25-25 ITAA 1997
Total expenditure <$100 written off in year incurred | s.25-25(6)
Total expenditure >$100 written off over the lesser of 5 years or period of loan | s.25-25(4)-(9)
WIP | s.25-95 ITAA 1997
Bad Debts incurred in ordinary course of business; Provisions CANNOT be deducted | s.25-35 ITAA 1997
Loss by Theft or Embezzlement | s.25-45 ITAA 1997
Capital Allowances - depn Assets can be written off | Div 40 ITAA 1997
R&D Costs | s.73B ITAA 1936
Superannuation Contributions for eligible employees to complying Fund | s.82AAC(1) ITAA 1936
Mortgage discharge expenses | s.25-30 ITAA 1997
Loss from profit-making undertaking | s.25-40 ITAA 1997
Electation expenses | s.25-50 to 25-70 ITAA 1997
Gift or contributions | Div 30 ITAA 1997
Car expenses | Div 28 ITAA 1997
Repairs | s.25-10. TR 97/23

GST AND DEDUCTIONS

If an ITC is available then the deductible amount will be exclusive of GST
If an ITC is not available then the deductible amount will include the GST

NON-DEDUCTIBLE ITEMS (cannot deduct)

Capital in Nature: Sun Newspapers Ltd and Associated Newspapers Ltd v FCT

1. Deductions

1. Eduring benfit
2. Once and for all vs short term
3. lump sum compared to series of sums

Deductible under:
- Div 40: Depreciating Asset
- Div 43: Construction of income producing building
- CGT Cost Base: s.40-880 Black-hole provision for over 5 years

Entertainment:
- s.32-5 ITAA 1997
- s.32-20 ITAA 1997
- Provided as a fringe Benefit
- Taxpayer's business is to provide entertainment
- Is provided in provision of G&S to the public
- Entertainment Allowances are deductible
- Provided in an in-house dining facility
- s.32-30 ITAA 1997

Interest or borrowing Costs to pay income tax | s.25-5(2)(c) ITAA 1997
Club Fees and Leisure facilities | s.26-45 ITAA 1997
Spouse Travel (unless provided as Fringe Benefit) | s.26-30 ITAA 1997
First $250 of certain self-education expenses | s.82A ITAA 1936
TAX AVOIDANCE | PART IVA ITAA 1936
DOUBLET DEDUCTIONS | ss.8-1 ITAA 1997
Penalties and Fines | s.26-20 ITAA 1997
HECS (unless provided as Fringe Benefit) | s.26-60 ITAA 1997
Superannuation Contributions Surcharge | s.26-53 ITAA 1937
Bribes | s.26-5 ITAA 1997
GST input tax credits | s.27-5 ITAA 1946
Leave only deductible when paid out | s.26-10 ITAA 1997

1. Deductions