

Henry Review

A broad review of the Australian tax system, excluding the GST, was undertaken by a panel headed by the then Treasury Secretary Dr Ken Henry in 2008 and 2009. The review panel provided a final report to the Treasurer in December 2009 with 138 recommendations. The government responded to the report in May 2010, indicating that its response was intended to be the first step in a 10-year reform agenda.

The centrepiece of the government's response was that it would introduce a new resource super profits tax or RSPT (ie, minerals resource rent tax (MRRT), repealed in 2014). The government also specifically rejected some recommendations (eg reducing the CGT discount and removing the Medicare levy), and flagged some areas for future reform. Subsequently, Treasury was given the task of developing and implementing the government's response to the Henry Review, and of informing the community about the government's tax reform agenda.

Tax forum

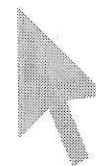
The government convened a tax forum in October 2011 to discuss priorities and directions for further tax reform. As part of the "second wave of tax reform", the forum discussed the broad sweep of topics covered in the Henry Review (excluding the MRRT), and included six sessions on: (1) personal tax; (2) transfer payments; (3) business tax; (4) State taxes; (5) environmental and social taxes; and (6) tax system governance (www.treasury.gov.au/Policy-Topics/Taxation/Tax-Forum).

Consequently, a business tax working group was formed, which reported that it was unable to recommend a revenue-neutral package to lower the company tax rate. In addition, the then Assistant Treasurer said that key outcomes from the forum included looking at reform of the not-for-profit concessions, and the rules governing superannuation annuities.

Future tax reform

The government released a tax discussion paper in March 2015 to begin community consultation on future tax reform. However, following completion of the consultation period, the government decided that it would not persist with the previously proposed process of issuing a green (options) paper and a white (policy) paper. The government instead announced its tax reforms in the 2016/17 Federal Budget (¶1-700).

Chapter 2 Individuals



Access additional tools & resources

Visit: www.wolterskluwer.cch.com.au/cchiknow

Search: *Individuals*

	Para
WHO MUST FILE A RETURN?	
Resident individuals	2-000
Non-resident individuals	2-010
RETURN FORMS	
Tax return forms, instructions and e-tax for individuals	2-030
Due date for lodgment of tax returns for individuals	2-060
Where to file a tax return for individuals	2-070
Date of death tax returns	2-080
CALCULATION OF TAX LIABILITY	
Calculation of tax payable: ordinary resident individual	2-090
Quick reference chart for calculating tax liability	2-110
RATES OF TAX	
General rates of tax: individual taxpayers	2-120
Reduction of tax-free threshold	2-130
Budget repair levy	2-131
Means-tested family assistance	2-133
INCOME AVERAGING SCHEME	
Application of the income averaging scheme	2-140
Classes of special professionals	2-142
Calculation of tax under income averaging scheme	2-144
INCOME OF MINORS	
Special tax payable by minors	2-160
Which minors are within the rules?	2-170
What income of minors is caught by special rules?	2-180
Anti-avoidance provisions relevant to minors	2-190
Trust income of minors	2-210
Calculating the tax of minors	2-220
Tax payable on income from trust estate to minor	2-250
MEDICARE LEVY	
Who is liable to pay Medicare levy?	2-290
Meaning of married for Medicare purposes	2-300
Who is a dependant for Medicare levy purposes?	2-310
Rate of Medicare levy	2-320
Relief from Medicare levy for low income earners	2-330

Medicare levy surcharge	2-335
Exemptions from Medicare levy for prescribed persons	2-340
Partial relief from Medicare levy	2-360
Collection of Medicare levy and surcharge	2-370
HIGHER EDUCATION SUPPORT	
Higher Education Loan Programme	2-380
Tertiary Student Financial Supplement Scheme	2-385

Who Must File a Return?

¶2-000 Resident individuals

The requirements for lodging annual returns are set out by the Commissioner towards the end of each financial year via Legislative Instrument (see the Australian Government ComLaw website at www.comlaw.gov.au).

For the 2015/16 income year, resident individuals whose total taxable income for the year from all sources exceeds the tax-free threshold of \$18,200 are generally required to lodge a return (¶2-120). Individuals with taxable incomes below the tax-free threshold are also required to file a return in various situations, such as where: (1) PAYG amounts have been withheld from their pay or income; (2) they have prior year losses or a loss in the current year (¶16-880); (3) they carried on a business; (4) they had a reportable fringe benefits amount included on their payment summary; (5) they wish to claim a refund of imputation credits; (6) they had an individual interest in the net income or loss of a partnership; (7) they were entitled to claim the private health insurance tax offset; (8) they were entitled to a distribution from a trust which carried on a primary production business; or (9) they were a special professional covered by the income averaging provisions (¶2-140).

A return of income must also be filed by a resident unmarried minor whose total income — other than income from employment or from personal services rendered exceeds \$416 (¶2-160).

Special lodgment requirements apply to taxpayers entitled to certain government pensions, allowances and benefits.

As to more detailed requirements and the Commissioner's power to require returns to be furnished irrespective of the level of income, see ¶24-010.

Residents of Norfolk, Cocos (Keeling) and Christmas Islands are treated as residents of Australia for the purposes of assessment and payment of tax. Special provisions to exempt Norfolk Island residents from tax on Norfolk Island and ex-Australian income no longer apply, from 1 July 2016 (¶10-640). The self-governing status of Norfolk Island ended from 1 July 2016. As a result, the income tax exemptions that applied to Norfolk Island residents in relation to their Norfolk Island sourced income and their foreign sourced income have been repealed, bringing them fully into Australia's income tax system from 1 July 2016.

The government has announced that a "backpacker tax" will not be introduced on 1 July 2016, as originally proposed. In the 2015 Budget, the government announced a measure (commonly referred to as the "backpacker tax") to treat temporary working holiday makers as non-residents for tax purposes. The effect of the measure would result in those individuals being taxed at 32.5% from their first dollar of income. To date, these proposed changes are yet to be enacted into law. The government subsequently announced that these changes will be deferred from 1 July 2016 for six months pending the outcome of a review of workforce shortages faced by agriculture and tourism industries. The review will also assess Australia's competitive position in attracting seasonal and temporary labour, including comparative wages and taxation.

Individuals who are resident for only part of the income year are required to lodge a return if their taxable income exceeds \$13,464 plus \$395 for each month of residence (including the month in which the person became, or ceased to be, a resident: ¶2-130). For details of the tests of residence, see ¶21-010.

[FTR ¶79-320]

¶2-010 Non-resident individuals

Non-resident individuals are required to file a return if they earned *any* income from sources in Australia other than dividend, interest or royalty income subject to withholding tax. For more detailed requirements, see ¶24-010. For the taxation of non-residents generally, see ¶22-000.

[FTR ¶79-320]

Return Forms

¶2-030 Tax return forms, instructions and e-tax for individuals

The return form to be completed by individuals and the individual tax return instructions are distributed by the ATO (¶44-000). There is a separate return form (Form I) for use by tax agents.

There is also a tax return supplementary section, and an instructions supplement.

Certain information should be recorded in the individual tax return instructions or equivalent records, and taxpayers should retain the records in case the ATO requires that information to be produced at a later date.

An individual must personally sign the return and must also complete a declaration as to the correctness of the return. Where the return contains a claim subject to the substantiation rules, the individual must also make a declaration to the effect that the relevant substantiation records are held. Where a return is prepared by a tax agent, the agent must complete the tax agent's certificate on the return.

As an alternative to paper lodgment, individuals may lodge their returns via the Internet using "myTax". The ATO's legacy online lodgment tool "e-tax" has been retired in 2016. It has been replaced with an expanded myTax which will be available on 1 July 2016.

Introduced in 2014, myTax is the ATO's more modern service, allowing tax returns to be lodged quickly and conveniently on tablets, smartphones and any computer using a web browser. It was originally specifically designed for taxpayers with straightforward tax affairs and is a fully online service rather than requiring software to be downloaded and installed like e-tax. Initially, taxpayers having business income or losses, rental properties, partnerships or trusts, capital gains or losses, employee share schemes and superannuation income streams were not eligible to use myTax. MyTax has been regularly expanded, however, enabling taxpayers with rental properties, tax offsets, lump sum payments, managed investment funds and foreign pensions to lodge their returns using it. From 1 July 2016, sole traders and contractors will also be eligible to use myTax, thereby making it suitable for any taxpayer who wants to lodge their own return, regardless of their tax affairs. Tools and calculators have also been integrated into myTax, for example, allowing property investors to record depreciation and capital gains.

Within myTax, there is a pre-filing service which partially completes an individual's tax return by downloading information into it using data the ATO already has from previous returns, and current year information from organisations required to report to the ATO, such as employers, banks and government agencies.

To lodge a tax return online, individuals will need to get a myGov account (my.gov.au) and link to the ATO as a member service. Once linked to the ATO, individuals can use their myGov account to manage tax affairs. Personal details can be updated, arrangements made to pay a debt and progress of previously lodged tax returns can be checked.

An ATO free app, "myDeductions" is also available to help taxpayers keep track of work-related expenses they wish to claim in their tax return. The app also records other common deductions like gifts, and tax agent fees. If taxpayers use myDeductions they will have the option of uploading their completed deductions data to the ATO, which will use this information to pre-fill myTax returns.

For further details on the requirements relating to completion and optional electronic transmission of returns, see ¶24-010.

Tax receipts

From the 2014/15 year, the Commissioner is required to issue a tax receipt to individual taxpayers whose total tax assessed (ITAA97 s 4-10(3)) is \$100 or more for the income year (TAA Sch 1 s 70-5). The tax receipt will include information about how the total tax assessed for the year is notionally used to finance different categories of Commonwealth government expenditure.

[FTR ¶79-305, ¶79-329, ¶977-415/205]

¶2-060 Due date for lodgment of tax returns for individuals

The due date for lodgment of returns is generally 31 October. Individuals preparing and filing their own returns may, if unable to file by the due date, apply to the ATO for an extension of time (¶24-070). Reasons must be stated.

Penalties are imposed for late lodgment of returns (¶29-100) and, therefore, any application for an extension of time for filing should be made *before* the due date.

Special extension arrangements apply to returns prepared by tax agents to enable agents to spread their work over a substantial part of the year.

[FTR ¶79-310]

¶2-070 Where to file a tax return for individuals

Where the Commissioner directs a taxpayer to lodge a return at a particular address, the taxpayer must lodge the return at that address. To expedite the processing of returns, the tax return instructions ask taxpayers to lodge their returns at the lodgment address for the particular capital city (¶45-200).

Defence Force personnel should, unless directed otherwise by the ATO, lodge their returns at the office of the Deputy Commissioner in the state in which they are residing at the time that returns are due for lodgment.

The Northern Territory and the ACT are treated as states for return filing purposes, while Norfolk Island is treated as being in New South Wales and Cocos (Keeling) and Christmas Islands in Western Australia.

A return is not treated as duly lodged unless and until it is correctly completed and received, together with all the necessary annexures, at the ATO where it is required to be lodged.

[FTR ¶79-315]

¶2-080 Date of death tax returns

A return must normally be filed for a deceased taxpayer for the period from beginning of the relevant income year to the date of death of the taxpayer (TAA Sch 1 Subdiv 260-E). The return is filed by the executor or administrator of the deceased's estate and must include all assessable income derived (and all deductible losses or outgoings incurred) by the deceased in that period. The return may take into account expenditure incurred by a trustee in relation to the income tax affairs of the deceased

taxpayer (¶16-850) and unreimbursed medical expenses incurred by the deceased and paid by the trustee (¶15-320). The words "Deceased Estate" should be written at the top of the return form.

Date of death returns should generally be accompanied by a full and true statement of assets and liabilities valued at the date of death. However, if the deceased person was a salary or wage earner, such a statement will only be required if the Commissioner requests it. Once the assessment has issued and tax has been paid on it, the executor or administrator can rely on the assessment notice to distribute the assets of the estate, confident that the Commissioner will not seek to reopen the assessment at a later time.

A date of death return does not have to be filed if the taxpayer would not have been obliged to file a return, eg where the deceased taxpayer was a resident whose taxable income for the period to the date of death did not exceed the tax-free threshold and there are no other circumstances requiring lodgment of a return. In such a case, the executor or administrator should instead provide the Commissioner with a non-lodgment advice. A pro forma is provided in the tax return instructions.

Note that, with limited exceptions, any capital gain or loss arising from a CGT event as a result of the death of a taxpayer is disregarded (¶12-570).

For a checklist of the tax consequences of death, see ¶44-170.

[FTR ¶977-840]

Calculation of Tax Liability

¶2-090 Calculation of tax payable: ordinary resident individual

Tax payable by an ordinary individual resident taxpayer for 2015/16 is calculated as follows (ITAA97 s 4-10).

- (1) *Taxable income* is calculated. This is assessable income (eg salaries, wages, rents, interest), less all expenditure incurred in deriving that income (eg union dues, travel expenses, depreciation) and personal deductions (eg gifts to approved institutions, certain tax-related expenses).
- (2) The *gross tax payable* is calculated by applying the general rates of tax to the taxable income.
- (3) The *net tax payable* is calculated by deducting from the gross tax any *rebates/tax offsets* (eg the dependant (invalid and carer) tax offset, the zone rebate, the low income earner rebate and the medical expenses rebate).
- (4) An amount for the *Medicare levy* must be added equal to 2% of the taxpayer's taxable income (exemptions and reductions may apply: ¶2-290).
- (5) Where applicable, amounts must be added for Medicare levy surcharge (¶2-335) and for HELP repayments (¶2-380).

► Example

Jessica, an unmarried resident with no dependants, is a legal officer employed by a government department and has salary income of \$80,000 for the 2015/16 income year. Jessica also received interest income of \$264. Jessica was covered by private patient hospital insurance in 2015/16.

During the year, Jessica incurred the following expenses:

• subscriptions to legal periodicals	\$400.00
• membership fee for professional association	40.00
• tax return expenses	50.00
• gifts to public benevolent institutions	20.00
• medical expenses (net of refunds)	2,250.00

Jessica's taxable income and tax liability are calculated as follows:

Salary		\$80,000.00
Interest		264.00
Assessable income		<u>\$80,264.00</u>
<i>Less:</i>		
Subscriptions	\$400.00	
Membership fee	40.00	
Tax return expenses	50.00	
Gifts	20.00	510.00
Taxable income		<u>\$79,754.00</u>
Gross tax payable at 2015/16 rates on a taxable income of \$79,754 (¶42-000)		\$17,467.05
Plus: Medicare levy (2% × \$79,754)	\$1,595.08	
2015/16 tax payable		<u>\$19,062.13</u>

To arrive at the *actual tax payable/refundable*, the net tax payable will generally need to be adjusted for PAYG amounts withheld from salary or wages or from payments where an ABN or TFN has not been quoted, and/or any other credits (eg imputation credits).

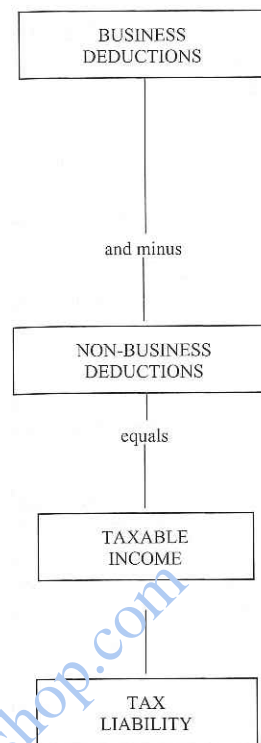
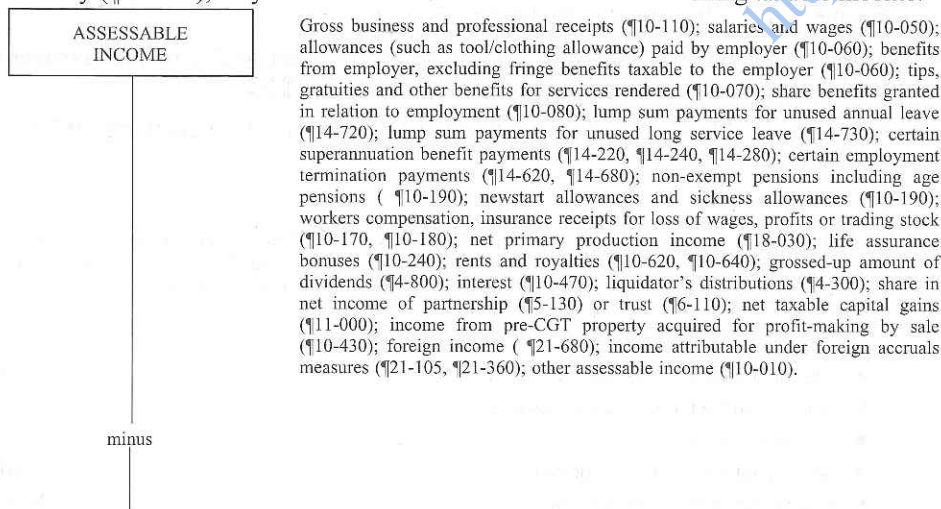
Special rules for calculating tax payable apply in a number of situations. These are where: (a) the taxpayer's taxable income includes a net capital gain (Chapter 12); (b) the taxpayer is a primary producer (¶18-200); (c) the taxpayer is an author, inventor, performing artist, production associate or sportsperson (¶2-140); or (d) the taxpayer is a minor with unearned income (¶2-160). Different tax-free thresholds also apply where a taxpayer changes residency (¶2-130).

[FTR ¶860-012]

¶2-110 Quick reference chart for calculating tax liability

The following chart shows the various income and deduction items which may be taken into account in determining taxable income and rebates and credits which may reduce gross tax. The items listed, which are general, are discussed in more detail at the paragraphs indicated.

Even though fringe benefits are, in some cases, reported on a taxpayer's payment summary (¶35-055), they are not taken into account when determining taxable income.



Expenses of carrying on business (¶16-015); employees' expenses (¶16-160); motor vehicle expenses (¶16-310); travel expenses (¶16-220); home office expenses (¶16-480); property and investment income expenses (¶16-650, ¶16-660, ¶16-670); depreciation (¶17-000); trade subscriptions or dues (¶16-430); special incentives for primary producers (¶18-050); cost of construction income-producing buildings (¶20-470); film industry investments (¶20-330); contributions to superannuation funds (¶13-710, ¶13-730); expenditure on environmental impact studies (¶19-060); environment protection expenditure (¶19-110).

Gifts (¶16-940); tax-related expenses (¶16-850); contributions to registered political parties (¶16-950).

Tax is applied to taxable income at general rates (¶2-120); subject to special provisions for minors (¶2-160), authors, inventors, performing artists, production associates and sportspersons (¶2-140), and primary producers (¶18-210).

From the resulting tax, deduct: dependant (invalid and carer) tax offset (¶15-100), low income earners rebate (¶15-300), rebate for net medical expenses (¶15-320), private health insurance offset (¶15-330), zone and overseas forces rebates (¶15-160 - ¶15-190), Senior Australians and pensioners tax offset (¶15-310), rebate in respect of employment termination payments, unused annual leave and long service leave (¶14-720, ¶14-730), rebate in respect of certain superannuation pensions and rollover annuities (¶13-160), rebate for eligible spouse superannuation contributions (¶13-770), social security beneficiary rebate (¶15-315), income arrears rebate (¶15-340), Medicare levy surcharge lump sum payment in arrears offset (¶15-350), rebate for assessable life assurance bonuses (¶10-240), tax offset for franked dividends (¶4-800), averaging rebate for primary producers where taxable income exceeds average income (¶18-210), foreign income tax offset (¶21-670).

The net tax remaining is adjusted for PAYG amounts withheld from salary or wages (¶26-150) or from payment when an ABN or TFN has not been provided (¶26-200).

An amount should be added for Medicare levy (¶2-290) and, where applicable, budget repair levy (¶2-131); Medicare levy surcharge (¶2-335), HELP repayments (¶2-380) and budget repair levy (¶2-131).

Rates of Tax

¶2-120 General rates of tax: individual taxpayers

In determining the rates of tax applicable to individual taxpayers, a distinction is made between residents and prescribed non-residents.

For rating purposes only, a person is treated as a resident if the person was a resident (¶21-010) at any time during the income year or was in receipt of a taxable Australian social security, military rehabilitation or veterans' entitlement pension, benefit or compensation. In any other case, the person is classed as a prescribed non-resident (*Income Tax Rates Act 1986*, s 3(1)).

Resident taxpayers are entitled to the benefit of a tax-free threshold. For 2015/16, the threshold is \$18,200. This means that the first \$18,200 of taxable income derived by a resident individual is tax-free (note, however, that the low income rebate (¶15-300) may apply to effectively increase this threshold).

Taxable income in excess of the threshold is taxed at progressive rates of tax, ie the average tax rate increases as the taxable income increases. The rates scale applicable to resident individual taxpayers is set out at ¶42-000 and a ready reckoner table showing the amount of tax payable at different taxable income levels is set out at ¶42-023. The government announced in the 2016 Budget that the threshold at which the 37% marginal tax rate for individuals commences will increase from taxable incomes of \$80,000 to \$87,000 from 1 July 2016.

There is no tax-free threshold for individuals who qualify as prescribed non-residents. They pay tax on the very first dollar of taxable income. However, like residents, the rate of tax increases as the taxable income increases. For the rates scale applicable to prescribed non-residents, see ¶42-015.

From the 2015/16 income year, a tax offset is provided to individuals who run small businesses (businesses with an aggregate annual turnover of less than \$2m), or who pay income tax on a share of the income of a small business. The amount of the tax offset is 5% of the income tax payable on the portion of an individual's income that is small business income. In addition to calculating the offset in this way, the maximum amount of the tax offset available to an individual in an income year is capped at \$1,000 (¶7-210).

[FTR ¶860-012]

¶2-130 Reduction of tax-free threshold

The standard tax-free threshold (\$18,200) is apportioned (or "pro-rated") in an income year in which a taxpayer becomes or ceases to be a resident (*Income Tax Rates Act 1986*, s 16 to 20). However, no additional threshold applies for income derived during the period the person was a non-resident. As a result, part-year residents are able to access a tax-free threshold of:

$$\$13,464 + [\$4,736 \times \text{number of months taxpayer was resident for the year} \div 12]$$

► Example

Luc arrives in Australia on 21 November 2015 to take up permanent residence here. He earns \$26,000 from 1 January 2016 to 30 June 2016. As Luc has been in Australia for eight months of the 2015/16 income year (including the month he became a resident), his reduced tax-free threshold is \$13,464 + [$\$4,736 \times 8 \div 12$] = \$16,621. The first \$16,621 of Luc's taxable income is tax-free. On the basis of the rates scale at ¶42-000, the remaining \$9,379 (\$26,000 - \$16,621) is taxed at 19%.

The threshold is not pro-rated on account of non-residency if, in the year of income, the person is in receipt of a social security or veterans' entitlement pension (other than sickness allowance, newstart allowance or special benefits) that is subject to Australian tax. Such taxpayers are entitled to the benefit of the full threshold.

Pro-rating of the threshold on account of non-residency may occur in more than one income year.

Trustees

Essentially, the same pro-rating calculation applies when calculating the tax payable by the trustee of a trust estate under ITAA 1936 s 98 in respect of the share of trust income of a presently entitled beneficiary under a legal disability, where there is a part-year residency period in relation to the beneficiary (*Income Tax Rates Act 1986*, s 20(1A), (2)).

[FTR ¶860-480]

¶2-131 Budget repair levy

From 1 July 2014 until 30 June 2017, a budget repair levy applies to resident and foreign resident individuals at the rate of 2% on that part of the taxpayer's taxable income over \$180,000.

The budget repair levy cannot be reduced by non-refundable tax offsets, ie the taxpayer's income tax liability for an income year is calculated as the taxpayer's basic income tax liability on taxable income less their tax offsets, to which the levy liability is then added. However, a taxpayer with excess foreign income tax offsets after applying them against their basic income tax liability may apply those excess offsets against their levy liability.

[FITR ¶15-120; FTR ¶860-012]

¶2-133 Means-tested family assistance

Family assistance, administered by the Department of Human Services, may be available to taxpayers with dependent children. These include Family Tax Benefit Part A, Family Tax Benefit Part B and Child Care Benefit. Taxpayers may also be eligible for a rebate of 50% of out-of-pocket child care expenses (Child Care Rebate), up to \$7,500 per child, with the maximum rebate amount remaining unchanged until 30 June 2017. For children born or adopted on or after 1 March 2014, a Baby Bonus is no longer available. Taxpayers may instead be eligible for Paid Parental Leave or the Newborn Upfront Payment and Newborn Supplement paid with Family Tax Benefit Part A payments. The payment of a Family Tax Benefit Part A supplement is conditional on a child meeting immunisation requirements.

The eligibility conditions and rates of payment of family assistance are set out in the *A New Tax System (Family Assistance) Act 1999*. The administrative, procedural and technical rules are set out in the *A New Tax System (Family Assistance) (Administration) Act 1999*.

Family assistance is received as direct fortnightly payments from the department, or as reduced child care fees.

Family assistance payments are exempt from income tax (ITAA97 s 52-150).

Income test

To be eligible for family assistance, a taxpayer must pass an income test ("adjusted taxable income") which takes into account income of the taxpayer's family. For this purpose, "family income" is the sum of the following amounts derived by the taxpayer and the taxpayer's partner:

- taxable income
- reportable superannuation contributions, ie the sum of the person's personal deductible contributions and reportable employer superannuation contributions made by the person's employer (¶13-730)
- total net investment loss, ie from financial investments (shares, interests in managed investment schemes (including forestry schemes), rights and options, and like investments), and from rental properties
- adjusted fringe benefits, ie reportable fringe benefits adjusted down for FBT paid by the employer
- income from certain tax-free pensions and benefits from the Department of Human Services or Veterans' Affairs
- target foreign income, ie any income, payment or benefit received from a foreign source that is tax exempt in Australia
minus the annual amount of any child support/child maintenance the taxpayer or the taxpayer's partner pays.

Family Tax Benefit Part A

Family Tax Benefit Part A helps with the costs of raising children and is paid per child. Eligibility is based on family income. The extent of entitlement depends on the ages and number of dependent children in the family. From 1 July 2015, family income can be \$51,027 a year before the Family Tax Benefit Part A payment is reduced. The payment reduces by 20 cents for each dollar from \$51,027 up to \$94,316. If family income is \$94,316 or more a year, the base rate of Family Tax Benefit Part A (\$57.68 in 2015/16) will reduce by 30 cents for each dollar over that amount until entitlement is lost. The base rate of Family Tax Benefit Part A does not include the base rate of Energy Supplement Part A (currently \$1.40 per fortnight). The maximum rate of Family Tax Benefit Part A applicable from 1 July 2015 is as follows:

For each child	Maximum FTB Part A rate per fortnight
Under 13	\$179.76
13–15	\$233.94
16–19, senior secondary school student	\$233.94
Up to 19 in an approved care organisation	\$57.68

These amounts do not include the Family Tax Benefit Part A supplement (\$726.35 from 1 July 2015), which may be paid after the end of the income year, or the Clean Energy Supplement Part A which varies in amount, depending on the age and status of the child or student, the maximum being \$4.48 per fortnight. A Family Tax Benefit Part A large family supplement may also be payable for the fourth and each subsequent child (\$12.46 per fortnight from 1 July 2015; before 1 July 2012 the supplement was payable for the third and each subsequent child). This supplement is proposed to cease from 1 July 2016.

Payment of the Family Tax Benefit Part A supplement is conditional on a child meeting the immunisation requirements. This applies to the income years in which the child turns one, two and five.

The rate of Family Tax Benefit Part A is increased for any income year in which there is a child born into a family, the family adopts a child or a child comes into the care of the family (such as by becoming a foster child of the family), unless one of the parents receives Parental Leave Pay for the child. For the 2015/16 income year, the amount of the increase is \$2,091.84 for the first child or \$1,046.25 for other children.

Family Tax Benefit Part A is paid to families only up to the end of the calendar year in which their teenager is completing school. Youth allowance will remain available to help young people transition from school into work or post secondary study. Exemptions will continue to apply for children who cannot work or study due to physical, psychiatric, intellectual or learning disability.

From 1 July 2015, a new allowance of \$750 per year for single parents on the maximum rate of Family Tax Benefit Part A for each child aged 6 to 12 years inclusive, and not receiving Family Tax Benefit Part B applies.

From 1 January 2016, families will only be able to receive Family Tax Benefit Part A for six weeks in a 12-month period while they are overseas. This measure will align the portability rules for Family Tax Benefit Part A with those of Family Tax Benefit Part B and most income support payments. Family Tax Benefit recipients will still be able to take multiple trips and retain Family Tax Benefit but each trip must be less than six weeks duration.

Family Tax Benefit Part B

Family Tax Benefit Part B is aimed at assisting single income families. It is payable where the primary earner's income or the sole parent's income is \$100,000 or less from 1 July 2015 (reduced from \$150,000 or less the previous year). However, the secondary earner's income is taken into account and this person can have an income of \$5,402 a year before payment is affected, with a reduction of 20 cents for each dollar of income over that amount. A secondary earner will still receive some Family Tax Benefit Part B if their income is below \$27,467 a year where the youngest child is under five, and \$21,353 if the youngest child is between 5 and 18. For 2015/16, the maximum Family Tax Benefit Part B rate is as follows:

Age of youngest child	Maximum FTB Part B rate per fortnight
Under 5	\$152.88
5–18	\$106.82

These amounts do not include the Family Tax Benefit Part B supplement (currently \$354.05 per family), which may be paid after the end of the income year, or the Clean Energy Supplement Part B (\$2.80 or \$1.96 per fortnight). The government proposes, from 1 July 2015, to limit Family Tax Benefit Part B to families with children under six years of age, with transitional arrangements applying to current recipients with children above the new age limit for two years. A new allowance of \$750 per child aged between 6 and 12 years will apply for single parents on the maximum rate of FTB Part A whose youngest child is between 6 and 12 years of age from the point when they become ineligible for the FTB Part B.

From 1 July 2016, FTB Part B will no longer be paid to couple families (other than grandparents and great-grandparents) with a youngest child aged 13 or over.

Child Care Benefit

Child Care Benefit assists parents, foster parents and/or grandparents with meeting approved and registered child care costs. Eligibility is based on family income. The extent of entitlement depends on factors such as the type of care used and the number of hours used. From 1 July 2015, if family income is less than \$43,727 a year, the family may be entitled to the maximum rate of Child Care Benefit depending on the type of care used, the hours it is used and whether the child goes to school. Part benefit may be payable in the following income ranges:

No of children in care	Annual family income
1	\$43,727–\$152,147
2	\$43,727–\$157,654
3 or more	\$43,727–\$178,023
	+ \$33,671 for each child after the third

The Child Care Benefit income thresholds will be maintained at the amounts applicable as at 30 June 2014 for three income years starting from 1 July 2014, with the first indexation of these amounts recommencing on 1 July 2017. The approved care Child Care Benefit rate for a non-school aged child from 1 July 2015 is \$4.17 per hour, or \$208.50 per week. Payment rates for school-aged children are 85% of the non-school aged rate. Depending on circumstances such as income amount, what type of child care service is used and the number of hours, there may be an entitlement to a different rate than stated. Up to 24 hours of care per child per week can be claimed, unless an individual and their partner meet the work, training, study test for Child Care Benefit which provides that they must each have work-related commitments of at least 15 hours a week or 30 hours a fortnight. If the test is met, or the individual and partner are exempt from it, up to 50 hours of care per child per week can be claimed. The registered care rate

enabling a consolidation election to be made. However, a number of schemes and scenarios are listed in the paper that might potentially attract the operation of Pt IVA. These include:

- a scheme to turn a subsidiary into a head company
- a scheme to split a consolidatable group into a number of such groups
- the acquisition of a subsidiary by a company that has no subsidiaries, predominantly to enable the company to consolidate
- a company arranging for itself to be acquired by another company to enable the latter company to elect to consolidate
- a head company of a consolidatable group acquiring a loss company and then electing to consolidate in order to utilise the losses
- the interposition of an entity resulting in the formation of a consolidatable group
- the leaving out of an entity from a consolidatable group prior to the group consolidating
- the shifting of value out of an entity in a consolidatable group prior to the group consolidating
- the disposal of an interest in a group company prior to the group consolidating
- the post-consolidation dissolution of a company
- the purchase of a minority interest in a group company prior to consolidation
- the use by a consolidatable group of a special purpose vehicle to issue preference shares to unrelated investors while maintaining 100% ownership of its subsidiaries
- the use by a consolidatable group of non-share equity interests to maintain economic control over a related party.

Part IVA may or may not apply in the above circumstances depending upon the facts and dominant purposes. Specific examples of the above scenarios are discussed in detail in the reference manual.

Where Pt IVA does apply, the Commissioner will generally seek to disallow only the actual tax advantage (net benefit) gained by the relevant taxpayer (eg the head company), rather than the entire tax benefit. However, where the net benefit cannot be readily determined, the Commissioner may disallow the entire tax benefit and then consider making compensating adjustments requested by the taxpayer under ITAA36 s 177F(3) where the taxpayer is able to demonstrate a fair and reasonable basis for such an adjustment.

The Commissioner's view is that Pt IVA applies to the arrangement involving a MEC group and the financing of an offshore investment described in ID 2012/50. The tax benefit, being interest deducted under ITAA97 s 25-90, was to be cancelled. Ownership of a US LLC was transferred from the ultimate US parent company to the Australian provisional head company of the MEC group. In exchange, the MEC group issued the parent company an interest-bearing promissory note. The stated commercial purpose of providing benefits of the Australian group having greater access to US clients could have been achieved using other simpler means. The dominant purpose was concluded by the Commissioner to be the obtaining of tax benefits.

Chapter 9 Tax Accounting • Trading Stock

Access additional tools & resources

Visit: www.wolterskluwer.cch.com.au/cchiknow

Search: *Tax Accounting, Trading Stock*

	Para
TAX ACCOUNTING	
Introduction to tax accounting	9-000
ACCOUNTING PERIOD	
The financial year and the income year	9-005
Substituted accounting period	9-010
Short period returns	9-020
ACCOUNTING METHOD	
Cash versus accruals basis	9-030
TIMING OF INCOME AND DEDUCTIONS	
Timing of income and deductions	9-035
Accounting profits and taxable income	9-040
Tax-effect accounting	9-042
Record-keeping	9-045
WHEN INCOME IS DERIVED	
Timing of income	9-050
Constructive receipt	9-080
Prepaid or estimated income	9-090
TIMING OF DEDUCTIONS	
Prepaid expenses, deferred charges and other timing situations	9-100
Prepayment and tax deferral schemes	9-110
Provisions for estimated expenses	9-120
TRADING STOCK	
What is trading stock?	9-150
Calculating trading stock gross profit	9-160
Trading stock on hand taken into account	9-170
VALUATION OF TRADING STOCK	
How to value trading stock	9-180
Cost of trading stock	9-190
Methods used to work out the cost of trading stock	9-200
Purchase of stock not at arm's length	9-210
Market selling value of stock	9-220
Replacement value of stock	9-225

	Para
Valuation of closing stock	9-230
Special value in case of obsolescence	9-240
Transfer of property to or from trading stock	9-245
Value shifting involving trading stock	9-247
LIVE STOCK	
Valuation of live stock	9-250
Valuation of live stock natural increase	9-260
DISPOSALS NOT IN ORDINARY COURSE OF BUSINESS	
Stock disposed of outside ordinary course of business	9-290
Partial change in ownership of stock	9-295
Trading stock on death of owner	9-300

Tax Accounting

¶9-000 Introduction to tax accounting

Tax accounting refers to the accounting methodology and practices required for the purposes of taxation law. Although the accounting requirements of taxation law sometimes reflect principles of financial accounting, the requirements of tax accounting are separate and contain some fundamental differences from financial accounting (¶9-040).

The relevant method of accounting determines not just how an item or transaction is to be treated but also in which period that treatment occurs.

Translation of foreign currency amounts into Australian currency

Rules dealing with the translation of foreign currency amounts into Australian currency are discussed at ¶23-070.

Accounting Period

¶9-005 The financial year and the income year

The *financial year* is the 12-month period starting on 1 July and ending on the following 30 June. Income tax is levied for each financial year by reference to a taxpayer's taxable income for an *income year* (ITAA97 s 4-10).

The income year is the same as the financial year, except in two cases (s 4-10(2)):

- For a company, the income year is the *previous* financial year. This distinction arose when a company's tax liability for a financial year was based on its taxable income from the previous income year. However, as companies now pay tax on a more current basis under the PAYG system of TAA Sch 1 (¶27-220 and following), the reference to previous financial year in the ITAA97 has limited practical significance.
- In some circumstances, a taxpayer's income year may be a substituted accounting period ending on a date other than 30 June (¶9-010).

[FTR ¶15-120]

¶9-010 Substituted accounting period

Generally, tax returns must be prepared on the basis of an income year ending on 30 June. However, with the Commissioner's permission, a substituted accounting period (SAP) ending on a date other than 30 June may be adopted (ITAA36 s 18).

The Commissioner's guidelines for approval of SAPs are set out in PS LA 2007/21. The practice statement sets out ATO policy in line with *MLC Investments Ltd*, and outlines three steps in the ATO decision-making process when assessing a SAP application:

- (1) determine whether the entity's circumstances warrant granting a SAP
- (2) determine how and when the entity moves from one accounting period to another
- (3) advise the applicant.

A decision to grant or withhold leave to adopt an SAP involves a balancing of convenience to the taxpayer with the general public interest in efficient administration of the Act. Each case has to be considered on its own merits and on the basis of all the relevant facts. Leave will generally be granted to adopt a SAP where it can be demonstrated that the circumstances take the case out of the ordinary run. This requires a consideration of the business needs relevant to the efficient administration of the taxpayer's business in their market. It would also be appropriate to consider other taxpayers in similar situations and the aggregate effect of grants of SAPs.

The Commissioner requires all applications for SAPs to be in writing and lodged in a timely fashion, ideally at the time when the circumstances which form the basis of the SAP application first arise. An application form (NAT 5087) is available on the ATO website.

Where leave to adopt a SAP ending on any date between 1 July and 30 November is granted, the SAP is in lieu of the income year ended on the preceding 30 June, ie the taxpayer is a late balancer. Where a SAP ends between 1 December and 30 June, the SAP is in lieu of the income year ending on the following 30 June, ie the taxpayer is an early balancer. For example, in the case of a SAP ending on 31 October 2015, the period 1 November 2014 to 31 October 2015 is in lieu of the income year ending on 30 June 2015. In the case of a SAP ending on 31 March 2015, the period 1 April 2014 to 31 March 2015 is in lieu of the income year ending on 30 June 2015.

In the year a company first adopts a SAP, it normally lodges a return for a transitional period shorter or greater than 12 months. For example, where leave is granted to an existing business to adopt an accounting period ending between 1 July and 30 November in lieu of the preceding 30 June, the first assessment for the new accounting period is based on its income for the period from 1 July in one year to the last day of the SAP in the following year, even though this exceeds 12 months. The practice statement provides a table that sets out the length of transitional accounting periods. Where a newly registered entity is granted a SAP, its first year will be the period starting on its date of incorporation or commencement of trading and ending on the next succeeding balance date of their requested SAP, ie it will not exceed 12 months.

Consolidated groups

When a consolidated group is formed, the head company continues to use its existing tax accounting period. Its payment, reporting and lodgment obligations (as head company of the group) will be based on this period. A subsidiary member retains its own balance date when entering the group. On exit from the group the subsidiary will continue with the balance date it had on entry unless it has applied for and had a different balance date approved.

[FTR ¶6-585]

¶9-020 Short period returns

Ordinarily, no return is allowed for a period of more than 12 months, except in certain cases where there is a change to or from a substituted accounting period (¶9-010). However, a return for a period of less than 12 months must often be lodged. For example:

- A return for a deceased taxpayer is lodged for the period from the first day of the income year to the date of death.

- A separate return is made for the estate on the income from the date of death to the close of the estate's income year.
- A new taxpayer must lodge a return for the period from the date on which income commenced to be derived to the last day of the income year.
- A return is lodged for a dissolved company from the first day of the income year to the date of dissolution.
- Where there is any variation in the membership of a partnership, a return may need to be lodged for the partnership as originally constituted from the first day of the income year to the date of the variation, with a separate return being lodged for the reconstituted partnership from that date to the end of the income year (¶15-060).
- Where a trust is created or terminated, a return must be lodged for the period from its creation to the end of the income year, or from the first day of the income year to the trust's dissolution.
- A subsidiary that joins or leaves a consolidated group during the subsidiary's income year must lodge a return (¶18-000). The ATO has emphasised that the subsidiary does not lodge a part-year return but is still required to lodge a return for the whole income year at the normal lodgment time. However, only income and deductions properly attributable to the non-membership period(s) are to be included (see page 5 of the Company tax return instructions 2015).

[FTR ¶79-300]

Accounting Method

¶9-030 Cash versus accruals basis

Taxable income must be computed not only on the basis of a fixed accounting period, but also in accordance with the *method* of accounting that correctly reflects the true income (*CT v Executor & Trustee Agency Co of South Australia (Carden's case)*). There are currently two methods of computing income for tax purposes:

- the cash or receipts basis, and
- the accruals or earnings basis.

The cash basis of accounting is the method used by most individuals. Under this method, income is returned in the year when it is actually or constructively received, either in the form of cash or its equivalent, or other property. Deductions are claimed in the year the expenses are incurred (TR 97/7; ¶16-040) within the meaning of ITAA97 s 8-1 and deductions allowable under special provisions (eg film investments) are deductible in accordance with the particular provision giving the deduction.

Under the accruals method, income is accounted for when the right to receive it comes into being, ie when all the events that determine the right have occurred. It is not actual receipt but the *right to receive* that is critical. Deductions are claimed in the year that expenses are incurred, adopting the same principles that apply to cash basis taxpayers.

Whichever of the two accounting methods is adopted must be adhered to strictly. A taxpayer on a cash basis cannot return income in a year other than that in which it is received, even if it relates partly to another year, or expenditure incurred in gaining it is deductible in a different year.

In certain circumstances, a taxpayer may wish to change the method of accounting from a cash to an accruals basis or vice versa. However, the determination as to which particular accounting method truly reflects income in the particular circumstances rests with the courts (*Henderson*). The considerations to be taken into account when such a change is proposed are discussed at ¶31-120.

Generally, the mere act of consolidation will not affect the choice of income recognition method for business activities carried out by a consolidated group (TD 2005/3).

Guidelines for choice of tax accounting method

Guidelines for choosing which method of tax accounting is likely to provide a substantially correct reflex of income in a given income year are set out in TR 98/1. According to the ruling, a cash basis is likely to be appropriate for income derived as an employee, for *non-business* income derived from providing knowledge or skill and for income derived from investments. However, the ruling lists exceptions to the general rule, which relate to interest income (¶9-050).

The cash basis may also be appropriate for *business* income derived from providing knowledge or skill. However, the presence of the following factors to a significant degree may result in the accruals basis being more appropriate:

- the taxpayer's activities involve the sale of trading stock
- the taxpayer's outgoings in the day-to-day conduct of the business relate directly to income derived
- the taxpayer relies on circulating capital or consumables to produce income, or
- the taxpayer relies on staff or equipment to produce income.

The accruals basis is usually appropriate where a trading or manufacturing business is involved. Where a taxpayer has business income from more than one business activity, a separate evaluation should be made for each activity and a determination made as to which method is appropriate for the accounting of that income. In most cases, the same method is likely to be appropriate for income from all business activities. Fine distinctions are not necessary where the differences between the various business activities are not significant.

Professional practices

It is not always clear which accounting basis (ie accruals or cash) a professional practice should use to return income. In *Henderson* it was held that, for a large firm of accountants, the accruals basis was appropriate to reflect its income and the Commissioner could not insist on the firm continuing with the cash basis. Moreover, in the year of changeover, there was no basis for bringing to account any amount for fees earned but uncollected at the end of the immediately preceding year. A similar decision was reached in *Barratt*.

On the other hand, the cash basis is the correct method of tax accounting for a solicitor or accountant in sole practice (*Firstenberg; Dunn*).

Clearly *Henderson* and *Firstenberg* represent the extremes and most professional practices lie somewhere in between. The reasoning in each case does not provide any guide as to where the line should be drawn between those cases where an accruals basis is appropriate and those where it is not.

In *Dormer*, an accountant was assessable on a cash receipts basis on income received from his former sole practice and on an accruals basis on income derived from a new partnership in the same income years. The Full Federal Court distinguished the case from *Henderson* on the basis that the new partnership was a different business from the sole practice.

[FTR ¶27-000ff, ¶27-030ff]

Timing of Income and Deductions

¶9-035 Timing of income and deductions

Determining taxable income (¶10-040) involves applying principles of tax accounting to identify all items of assessable income (¶10-000) and all allowable deductions (¶16-000) for a particular period. Whether an item is relevant to a particular period is a *timing* issue.

The main issue relating to when income is assessable is the time it is *derived* (ITAA97 s 6-5) (¶9-050).

If expenditure has been incurred (but not actually paid), a deduction is only allowable to the extent that the expenditure is properly referable to the income year, ie to the extent that the benefit derived is put to profitable advantage or used in the taxpayer's income-producing activities in the relevant income year (*Coles Myer Finance*; TR 94/26; TR 97/7; ¶16-040). Even though there are specific deduction provisions that do not depend on the concept of "incurred" (eg ITAA36 s 70B which allows a deduction for certain traditional securities in the year of disposal), the concept is generally relevant.

While deriving income and incurring deductible expenditure seem to be different aspects of the same timing issue, the judicial interpretation of each has evolved on a largely separate basis.

[FTR ¶18-200, ¶27-000]

¶9-040 Accounting profits and taxable income

The net profit (or loss) shown in a taxpayer's accounts is not necessarily the net profit (or loss) for tax purposes.

Accounting and tax profit or loss figures may differ for many reasons. For example:

- Plant may be depreciated in the accounts at a rate different from that allowed for income tax purposes.
- Certain capital expenditure amortised in the accounts may be allowed as an outright deduction for tax purposes, may be deductible over a different time frame or may not be deductible at all.
- Trading stock may be valued in the accounts on a basis different from that adopted for tax purposes (¶9-180).
- Provisions for holiday pay and long service leave, in accordance with prudent accounting, are charged against profits in the accounts but are not deductible for tax purposes (¶9-120).

¶9-042 Tax-effect accounting

The Australian Accounting Standards Board's (AASB) Accounting Standard AASB 112: *Income taxes* prescribes the accounting treatment for income taxes in financial reports of for-profit Australian entities. It adopts a balance sheet approach and incorporates international standard IAS 12.

Some key principles and requirements of AASB 112 are:

- Unused tax losses that the income tax law allows to be carried forward give rise to deferred tax assets. These deferred tax assets must be recognised to the extent that it is probable that future taxable amounts within the entity will be available against which the unused tax losses can be utilised.
- A deferred tax asset must also be recognised for all deductible temporary differences (subject to certain qualifications), to the extent that it is probable that the temporary difference will reverse in the foreseeable future and future taxable amounts will be available against which the deductible temporary differences can be utilised.
- A deferred tax liability must be recognised for all taxable temporary differences (subject to certain qualifications).
- Deferred tax liabilities and assets must be measured having regard to the manner in which the entity expects (at reporting date) to recover or settle the carrying amount of its assets and liabilities based on the tax rates and tax laws that have been enacted or substantively enacted by the reporting date.
- Current or deferred tax is to be recognised as expense or income in the net profit or loss for the reporting period, unless it is required to be recognised as a direct debit or credit to equity, or as a direct adjustment to goodwill.

In very general terms, temporary differences are those where the difference between the tax and accounting treatment is one of timing, ie the treatment will coincide over time when multiple periods are taken as a whole. An example would be depreciation of an asset using different depreciation rates for tax and accounting purposes. By way of contrast, permanent differences (eg where fines are disallowed for tax purposes or where R&D deductions exceeding 100% of actual cost are recognised for tax purposes) will not coincide over time. The standard provides numerous examples of assessable and deductible temporary differences that may arise.

Other accounting guidelines

Other financial reporting guidelines that are relevant to income tax include:

- UIG Interpretation 125: Income Taxes — Changes in the Tax Status of an Entity or its Shareholders
- UIG Interpretation 1052: Tax Consolidation Accounting.

¶9-045 Record-keeping

Every taxpayer carrying on a business must keep records that record and explain all transactions and other acts engaged in by the taxpayer that are relevant for tax purposes, including:

- any documents that are relevant for the purpose of ascertaining the taxpayer's income and expenditure
- documents containing particulars of any election, estimate, determination or calculation made by the taxpayer and the basis on which any estimate, determination or calculation was made (ITAA36 s 262A).

All these documents must be kept even though, as a result of self-assessment, they may not actually have to be lodged with a tax return (¶25-000).

Records must be kept in such a way as to enable the person's tax liability to be readily ascertained. They must be kept in writing in the English language. Alternatively, they may be kept in electronic form, provided they are readily accessible and convertible into writing in English (TR 96/7).

Electronic records will meet the record-keeping and access requirements of the tax law provided certain principles are observed (TR 2005/9). For example:

- Information stored in electronic form must be "readily accessible so as to be usable for subsequent reference", as required by the *Electronic Transactions Act 1999*.
- It is the record-keeper's responsibility to ensure that usability of the records is maintained over the retention period. An electronic record-keeping system must have adequate controls to safeguard the security and integrity of the records and to minimise the risks of:
 - inadvertent destruction or corruption of electronic records
 - unauthorised tampering with electronic records
 - records becoming inaccessible due to changes in computer systems. A taxpayer should ensure the conversion of electronic records to compatible format when upgrading or changing data-processing capabilities.
- Electronic images stored in lieu of original paper records must be true and clear reproductions of the originals, not be altered or manipulated once stored, be retained for the statutory period of five years and be capable of being retrieved and read at all times by ATO staff. Optical character recognition conversion processes that do not produce a 100% accurate reproduction of original documents are not acceptable to the ATO.
- The taxpayer must keep records that explain all internet or EDI transactions that are relevant for tax purposes. The minimum information that must be recorded is the date, amount and character of the transaction.

- The entire electronic records system should be documented, including physical and logical descriptions of the systems structure and programs, including all inputs and outputs. However, the Commissioner has clarified the requirements in relation to off-the-shelf software packages for which taxpayers are generally not able to keep the computer system documentation (PS LA 2008/14). Tax officers can accept that taxpayers using commercial off-the-shelf software packages are maintaining appropriate system documentation where:
 - (a) the software name and version is recorded
 - (b) a record is made of the components of the software package that have been installed and the date of installation
 - (c) a chronological record is kept of all system changes or upgrades
 - (d) a record is made of the options that have been enabled or disabled, and
 - (e) any manuals or instructions provided with the software package are kept.
- The occupier of a building or place must provide an authorised officer with all reasonable facilities and assistance for the effective exercise of powers under TAA Sch 1 s 353-15 (¶25-220). In the context of electronic records, this includes the provision of login codes, keys and passwords, and manuals.
- It is generally not necessary to retain a hard copy of the information contained in an electronic record unless a particular law or regulation requires the taxpayer to retain paper copies.

If records are kept in encrypted form, the taxpayer must (on request) provide the ATO with either decrypted records or the encryption key and all other means required to decrypt the records (TD 2002/16).

Records are normally required to be retained for five years from the date on which the record was prepared or obtained or from the time the relevant transaction or act was completed, whichever is the later. If the period within which the Commissioner can amend a taxpayer's assessment is extended (¶25-300), the retention period for the records is correspondingly extended. A taxpayer who has incurred a tax loss should retain records supporting that loss until the end of the statutory record retention period or the end of the statutory period for reviewing assessments for the income year in which the loss is fully deducted, whichever is later (TD 2007/2).

The maximum penalty under s 262A for failing to comply with the record-keeping requirements is a fine of 30 penalty units (ie \$5,100: see *Crimes Act 1914*, s 4AA).

Special record-keeping requirements are contained in the substantiation rules (¶16-210), the CGT provisions (¶11-920), the transfer pricing provisions (¶22-630) and the FBT legislation (¶35-690).

Note that statutory provisions under other legislation may require retention of business records for a longer period than that specified in s 262A, eg *Corporations Act 2001*, s 286 requires a company to retain accounting records for a period of seven years after completion of the transaction to which they relate.

A checklist of the main types of tax records that need to be kept by individual taxpayers is provided at ¶44-100.

[FTR ¶785-080]

When Income is Derived

¶9-050 Timing of income

An annual basis of taxation involves the computation of income derived during a particular income period (ITAA97 s 6-5). It is, therefore, not only necessary to consider whether an item is *income* but also whether it has been *derived*.

The question of when income is derived depends on the nature of the income and, in some cases, on the nature of the income-earning activities of the taxpayer who derived the income. Constructive receipt of income is considered at ¶9-080 and prepaid income is discussed at ¶9-090. Several categories of income and taxpayer circumstances are described generally below.

Trading income

Trading income generally is derived when the right to receive it arises as a debt due and owing (eg *Case 39/96*). Income from the sale of goods for a specified sum generally is derived when the goods are delivered.

Lay-by. Income from lay-by sales is derived when the buyer pays the final instalment and the goods are delivered to the buyer. When a lay-by sale is terminated early, any amount forfeited by a buyer and any associated costs (eg handling and storage) that the seller is entitled to retain are income derived by the seller when the sale is terminated. A non-refundable service fee or other non-refundable fee, deposit or charge is derived by the seller when the lay-by sale is entered into (TR 95/7).

Conditional contracts. Under a conditional contract, income is assessable to the seller on accepting the purchase order and a deduction is allowable if the goods are subsequently returned under the terms of the contract (TR 97/15).

Bona fide dispute. Where part of the consideration for a supply was subject to a bona fide dispute and not paid on invoice, the disputed income was held to be derived when the dispute was settled and not when the commodity was supplied or invoiced (*BHP Billiton*). The unanimous Full Federal Court decision in *BHP Billiton* was consistent with earlier decisions in United States and Canadian cases. The court also observed that, where consideration has been received but is under dispute, income may be derived at the time of receipt.

Trading stock discounts. Where trading stock is sold under an arrangement that provides for a prompt payment discount (eg 5% discount on invoice price if paid within 30 days), income is assessable to the seller at the time of sale for the full invoice price. If the discount is subsequently accepted, then the difference between the invoice price and the discounted price is deductible at the time payment is received. In the case of cash discounts, trade discounts and quantity or bulk discounts, the discount is taken up at the time of sale and only the discounted price is assessable at that time (TR 96/20). This treatment of trading stock discount still applies if the discount is accumulated in an account, applied to the acquisition of new shares in the seller or transferred to an affiliate of the buyer (TD 96/45). However, the High Court decision in *Ballarat Brewing* suggests that only the discounted price should be recognised at the time of sale where receipt of the discount is virtually certain.

Commission income. An insurance broker derives commission when it first becomes available for withdrawal from the broker's Insurance Broking Account. Where an insurance agent (as distinct from a broker) retains commission from premium moneys payable to an insurer, the commission income is derived at the time the gross premium is received by the agent from the insured. If the gross amount of the premium is paid directly by the insured to the insurer, the commission is normally treated as being derived by the agent or broker at the time of its receipt from the insurer (IT 2626). For other rulings on the timing of derivation of commission income, see TD 93/149 (travel agent commissions) and TR 97/5 (real estate agent commissions).

Premium income. Premiums arising from a general insurance contract that extends beyond the income year are not considered to have been derived by an insurer wholly in that year. To the extent that the net premium income relates to risk exposure of a later income year, it is derived for tax purposes in that later year or years. Premiums are generally apportioned on a days basis, except where the risk exposure is not spread evenly over time (IT 2663).

Motor vehicle dealers. For the Commissioner's guidelines on the point in time when holdback receipts and warranty indemnities are derived by motor vehicle dealers, see IT 2648.

Manufacturers' credits on aircraft purchases. Manufacturers' credits on the purchase of aircraft are normally assessable but are only derived when the right to receive the credits becomes unconditional (TR 96/6).

Pharmacists. Where a pharmacist returns income on an accruals basis, income from the supply of products under the Pharmaceutical Benefits Scheme (PBS) is assessable in the year in which it is derived. PBS income is derived at the time the product is dispensed to the customer (TR 96/19).

Primary production income. Where a primary producer delivers produce to a co-operative pool, etc, for disposal under a marketing scheme, income is derived when a debt for an ascertainable sum has been created (¶18-030).

Wheat and grain sales. For the Commissioner's views on when the proceeds of wheat and grain sales are assessable, see TR 2001/1 and TR 2001/5 (¶18-030).

Salary and wages

Salary and wages are generally derived when received, whether the amount is payment for current or past services. Back pay, arrears of pay that accrue during a period of suspension, retrospective award increases, lump sum workers compensation arrears and special bonuses are all assessable in the year of receipt (but a special rebate operates to limit the tax payable on these sorts of payments: ¶15-350).

An employee failed to defer derivation of back pay until after 30 June by refusing the tender of a cheque (*Case D62*). Another employee who received payment for a period of leave that extended into the following income year was unable to apportion the payment between the two years (*Hannavy*). A former employee receiving amounts related to him relinquishing claims with respect to an employee profit participation plan was held to have derived the amounts as and when they were paid to him or applied on his behalf (*Blank*).

Where an employee agrees to forgo a portion of normal annual salary in return for paid leave in a later period, the deferred salary component is not assessable until received, except where the amount is applied, accumulated or invested beforehand for the benefit of the employee (TD 93/242).

Professional fees

A professional person subject to the accruals method of accounting is treated as having derived fee income where a recoverable debt is created and the person is not obliged to take any further steps before becoming entitled to payment (*Henderson*). The same is generally true for disbursements on-charged to clients (TR 97/6). This depends on the terms of the contract or arrangement with the client. Most commonly, a recoverable debt is created when the taxpayer invoices the client, even if the invoice allows time for payment. Fees paid in advance are derived in the year the person completes the work to which the fees relate (¶9-090). A statutory impediment to a professional person commencing legal proceedings for the recovery of professional fees does not defer the time when income is derived (*Barratt*; TR 93/11). A professional person assessed on a cash basis derives fees and recouped disbursements at the time they are received.

In general, a professional person using an accruals basis of accounting need not bring anything into account as assessable income in respect of incomplete work or work in progress except where the contract provides for periodical accounts to be rendered for partially completed work. For the tax treatment of payments for work in progress where a professional partnership is reconstituted, see ¶5-070.

Doctors' fees collected from patients by a hospital as agent for the doctor are derived in the year they are paid by the patient, even though they are not actually received by the doctor until a later year (*Case T44*).

Management/service fees

Management/service fees are derived when a recoverable debt is created (*Lee McKeand*). On the facts in that case, a management fee was not derived until two to three years after the relevant costs were incurred.

In *Business Research Management*, management fees were "paid" to the taxpayer under a round robin series of paper transactions. The transactions involved limited recourse loans from the taxpayer's related party to investors. Corresponding amounts were on-paid to the taxpayer as management fees and paid back to the related party by the taxpayer as deposits. To the extent that the related party did not recover the limited recourse portions of the loans, the taxpayer would not recover its deposits, as the related party had no other funds. The taxpayer was held to have derived the entire amount of the management fees referable to the year in question at the time of the round robin transactions, even though the project had failed and the investors would never repay the limited recourse portions of the loans.

Interest

Interest is generally not derived until it has been received or the debt for interest has in some way been discharged. TR 98/1 states that, as a general rule, the cash basis is appropriate for determining income derived from investments. However, there are exceptions to the general rule, including:

- interest from a business of money lending carried on by the taxpayer
- interest derived by a financial institution, unless from a "non-accrual loan"
- interest from the everyday provision of credit as part of business activities
- interest derived by taxpayers, whose other income is calculated on an accruals basis, who invest in fixed or variable interest securities cum interest
- interest from deposits made in the ordinary course of carrying on a business, where the business income is properly assessable on an accruals basis, eg a large trading business that actively manages its funds on deposit.

Where these exceptions apply, the accruals basis is appropriate.

Banks and other financial institutions derive interest income as it accrues (*Australian Guarantee Corporation*; *Alliance Holdings*). A finance company entering into a debt defeasance arrangement is assessable on the difference between the face value of the debt and the amount paid to assign the debt only at the time when the debt matures and not at the time of entering the arrangement (*Unilever*).

The Commissioner has issued various guidelines giving his views on the timing of derivation of interest by financial institutions, as follows.

- The straight line daily accruals method is the appropriate basis on which financial institutions should bring interest income (and expenses) to account for tax purposes where the terms of the relevant contract indicate that the parties do not intend to disturb the ordinary rule that interest accrues on a daily basis over the period of the investment (TR 93/27).
- Interest relating to non-accrual loans is included in assessable income in the year it is received (TR 94/32).
- Interest paid in advance to a financial institution generally is derived by the institution at the time of receipt. However, where the loan agreement provides for a refund of prepaid interest to the borrower in the event of early termination of the loan, the financial institution should bring the prepaid interest to account over the period to which the interest relates (TR 1999/11).

Interest on overdue customer accounts owing to a business at the end of an income year is considered to be derived during that income year, not when the interest is received (IT 2227).

Accruals taxpayers investing in fixed or variable securities cum interest, where the principal and interest components are not marketed separately, should bring the interest to account on a due and receivable basis. Financial institutions, however, may bring such interest to account on a daily accruals basis, as with other interest income (TR 93/28).

See also Chapter 23 on the taxation of various types of financial arrangements.

Income from long-term construction projects

The following two methods are acceptable for accounting for long-term construction projects, ie contracts extending beyond an income year (IT 2450):

- the *basic* method, which involves the bringing of all progress and final payments received in a year into assessable income and the claiming of deductions for losses and outgoings as they are incurred. The Federal Court found this method to be appropriate in *Grollo Nominees*
- the *estimated profits* method, which permits the spreading of ultimate profit or loss on a long-term project over the years taken to complete the contract. Tender costs and unspecified expenses set aside as a management reserve cannot be taken into account under the estimated profits method (TD 92/131; TD 94/65). In *Grollo Nominees*, the Federal Court expressed some doubt as to the validity of the emerging profits method, emphasising that the ascertainment of taxable income had to be done annually.

A contract that runs for less than 12 months may still be a long-term construction project for this purpose, provided the contract straddles two income years (TD 92/186).

The completed contracts basis, under which the bringing of profits or losses into account is deferred until completion of the contract, is not an acceptable method of accounting for long-term construction contracts (*Grollo Nominees*). However, where a taxpayer enters into an arm's length contract that provides that the taxpayer is not entitled to receive any payment until completion of the contract, the income is not derived until the year in which the contract is completed. On the other hand, outgoings are deductible as they are incurred (IT 2450; TD 94/39).

Rent

Rent is generally derived for tax purposes when it is received. When so-called rent for a whole term is payable in advance, ascertaining whether it is derived when received or week-by-week as the term runs depends on the lease agreement and any other relevant factors.

Income from chattel leases. Taxable income from chattel leasing transactions should be calculated in accordance with the asset method, ie gross rentals less deductions by way of depreciation and balancing adjustment on disposal (IT 2594). A claim by a bank that it was entitled to use the finance method, rather than the asset method, to return income from leasing luxury cars (thereby avoiding the car depreciation limit) has been rejected (*Citibank*).

Income from transfer of land

Generally, if the income from the transfer of land is of a revenue nature it will be treated as derived when the income is received. In *Tagget*, it was decided that income from an agreement to transfer land is not derived until the actual transfer. The Full Federal Court upheld the assessment of an amount representing the market value of land when it was transferred to the taxpayer in 2005 (\$1,200,000) rather than its market value seven years previously when a deed of agreement to transfer the land was entered into (\$450,000).

Income from proprietary software licences or hosting

The Commissioner will consider income from the granting of a proprietary licence for software, or a software hosting arrangement (including bundled additional services) to be derived for the purposes of s 6-5 of ITAA97 when the obligation is fully performed or the contingency of repayment otherwise lapses (TR 2014/1). The contingency of

repayment refers to a contractual or commercial obligation to make a refund or a contractual exposure for damages. Taxpayers can defer income from these software arrangements where such a contingency for repayment still exists.

[FITR ¶18-200, ¶27-000]

¶9-080 Constructive receipt

Income that normally needs to have been received before it can be said to be derived may sometimes be deemed to have been received (ITAA97 s 6-5(4); 6-10(3)).

Constructive receipt is when income is credited without restriction and made available to the taxpayer. However, the income must be finally earmarked for the taxpayer. Salaries, directors' fees, retiring allowances, etc, merely credited in employers' books, but not able to be withdrawn at will, are assessable only when they are actually received or made available.

Common examples of constructive receipt include interest credited on fixed-term deposits and added to capital, interest credited on savings bank deposits even though not noted in the depositor's passbook, and dividends unqualifiedly credited and made subject to a shareholder's demand.

Cheques are generally regarded as payment when received and not when presented.

Income reinvested, accumulated, capitalised, carried to any reserve or sinking fund, or otherwise dealt with *on the taxpayer's behalf or as the taxpayer directs*, is constructively received.

Proceeds from the sale of mining tenements by a taxpayer that were not received by the taxpayer but by associated entities were still derived by the taxpayer because he had directed the sales proceeds to be paid to those entities (*Kirkby*).

The gross amount of an employee's wages (before deductions for PAYG withholding, employee superannuation contributions, health fund contributions, etc) is assessable. However, benefits received under an effective "salary sacrifice" arrangement are not assessable to the employee, and may be subject to fringe benefits tax (¶31-120). Dividends credited to a shareholder and, at the shareholder's direction, retained by the company as an advance are constructively received when credited.

A share in uncollected book debts sold as part of a retiring partner's interest in a partnership (that lodges returns on a cash basis) is capitalised on sale of the interest and assessed to the retiring partner. The purchaser is not assessed on subsequent collections of those debts (¶5-060).

As to the Commissioner's views on interest offset arrangements, see TR 93/6 (¶10-470). For a discussion on the transfer of rights to receive income, see ¶30-900.

[FITR ¶18-200, ¶28-000; FTR ¶6-700]

¶9-090 Prepaid or estimated income

Where advance amounts are received for a specific number of lessons or other services (eg dance or music lessons, a series of typing lessons) and such payments are brought to account as income in the taxpayer's accounts only when earned, they are treated as unearned income not assessable for tax purposes until they are earned (*Arthur Murray*).

This rule has been applied to prepaid magazine subscriptions (*Country Magazine*) and to an advance payment for a fixed-term maintenance and service contract (*Case C86*). The Commissioner applies the same principle to: (a) advance deposits for goods to be manufactured and delivered later at the buyer's request; (b) goods acquired under take or pay contracts, eg in the natural resource industry (TR 96/5); and (c) other cases where services are to be rendered over a fixed period of time (eg television servicing contracts).

Disposal of pooled assets

If a balancing adjustment event happens (eg the pooled asset is sold, scrapped, destroyed, lost, given away or otherwise disposed of), the closing pool balance for the year is reduced by the relevant termination value (¶17-640), eg the disposal proceeds (s 40-445). Where a percentage of the cost or opening adjustable value of an asset (representing expected private or exempt use) was originally excluded from the pool, a corresponding percentage of its termination value is ignored for these purposes. Where the termination value exceeds the closing pool balance for that year, the excess is included in the taxpayer's assessable income. No roll-over relief applies (eg ID 2003/1133).

The balancing adjustment event may also trigger CGT event K7 (¶17-670). In such case, the non-taxable use percentage (see above) of the excess of the termination value of the asset over its cost is a capital gain and the non-taxable use percentage of the excess of cost over termination value is a capital loss (ITAA97 s 104-245).

A taxpayer can continue to deduct the pool balance attributable to the asset, even though the taxpayer no longer holds the asset, eg if the termination value is less than the amount still to be written off (eg ID 2007/117).

▶ Example 4

Zoe sells the printer that she pooled in the Example above. The disposal proceeds (termination value) are \$200. The closing pool balance should be reduced by \$170 (ie 85% of \$200). There is a capital loss of \$60 (ie 15% × [\$600 - \$200]).

[FTR ¶87-800 - ¶87-855, ¶152-384]

¶17-830 Former depreciation rate pools

Under ITAA97 former Subdiv 42-L, taxpayers were able to aggregate (or pool) items of plant acquired before 1 July 2001 that were depreciable at the same depreciation rate. The depreciation pool was effectively treated as a single item of plant and depreciated using the diminishing value method only. For further details see the 53rd edition of the *Australian Master Tax Guide*.

[FTR ¶95-300 - ¶95-400]

Records and Accounting**¶17-880 Schedules and records for capital allowances**

Taxpayers claiming capital allowance deductions need to include the total amount on their tax return. A capital allowance schedule is no longer included with tax returns. To assist taxpayers with their calculations, the ATO has provided a worksheet in the *Guide to Depreciating Assets 2016* (www.ato.gov.au/Individuals/Tax-return/2016/In-detail/Publications/Guide-to-depreciating-assets-2016).

Documentation of purchase details must be obtained from the supplier (¶16-210, ¶16-340). Generally, records must be retained for five years (ITAA36 s 262A(4)(a)). For a useful records checklist, see ¶44-100.

Taxpayers will have a hard time proving depreciation deductions where inadequate records are kept and may be subject to penalties (*Rigoli*).

[FTR ¶785-080 - ¶785-120]

Chapter 18 Primary Production Concessions**Access additional tools & resources**

Visit: www.wolterskluwer.cch.com.au/cchiknow

Search: *Primary Production Concessions*



Para

CONCESSIONS FOR PRIMARY PRODUCERS

Summary of primary production concessions	18-000
Meaning of "primary production business"	18-010
Carrying on a primary production business	18-020
What is income from primary production?	18-030

SPECIAL DEDUCTIONS FOR CAPITAL EXPENDITURE

Special capital expenditure deductions	18-050
Telephone lines	18-060
Horticultural plants	18-070
Water facilities	18-080
Fodder storage assets	18-085
Fencing assets	18-090
Landcare operations	18-100
Timber depletion	18-120
Timber plantation concessions	18-125

ABNORMAL RECEIPTS

Primary production abnormal receipts	18-135
Double wool clips	18-140
Insurance recoveries for live stock and timber losses	18-150
Profit from forced disposal or death of live stock	18-160

INCOME AVERAGING

How the averaging system works	18-200
The averaging rules: a step-by-step process	18-210
Example: averaging adjustment — tax offset	18-250
Example: averaging adjustment — extra income tax	18-260
Election to withdraw from averaging	18-270
Permanent reduction of income	18-280

FARM MANAGEMENT DEPOSITS

Farm management deposits scheme	18-290
FMD eligibility rules	18-293
Making a farm management deposit	18-295
Withdrawing a farm management deposit	18-310

Concessions for Primary Producers

¶18-000 Summary of primary production concessions

The rules for calculating deductions and writing off capital expenditure incurred in primary production are contained in the uniform capital allowance system (ITAA97 s 40-510 to 40-675). This chapter covers the following tax concessions for taxpayers engaged in a primary production business ("primary producers"):

- annual deductions over 10 years for the cost of telephone lines (¶18-060)
- accelerated write-off for horticultural plants and grapevines (¶18-070)
- immediate write-off for capital expenditure on water facilities (¶18-080) and fencing assets (¶18-090)
- three-year write-off for expenditure on fodder storage assets (¶18-085)
- outright deduction for landcare operations (¶18-100)
- special deduction for timber depletion (¶18-120) and other timber industry concessions (¶18-125)
- tax deferral in relation to double wool clips (¶18-140) and spreading of insurance recoveries for live stock and timber losses (¶18-150)
- spreading or deferring the tax profit due to the forced disposal or compulsory destruction of live stock (¶18-160)
- income averaging for individual taxpayers (¶18-200)
- income equalisation benefits under the farm management deposits scheme (¶18-290).

The cost of planting annual crops is deductible under the general deduction provisions in the income year in which the expenditure is incurred. On the other hand, expenditure on planting trees, shrubs and similar long-lived plants is generally capital and non-deductible (¶18-020). As noted above, a special write-off is available for capital expenditure incurred in establishing horticultural plants, including grapevines.

Primary producers may, of course, qualify for the deductions allowable to taxpayers generally, for example, the 10-year write-off for electricity connection costs (¶16-820) and the deduction for repairs (¶16-700) and for the decline in value of depreciating assets (Chapter 17). For a list of the usual deductions allowable to primary producers, see the checklist at ¶16-005.

Non-residential buildings used in the primary production, forestry and pearling industries are treated as depreciating assets (¶43-100) as are employee amenities (eg sanitary ware, etc, forming part of toilet accommodation or washing facilities). Improvements to or fixtures on land, whether removable or not, are treated as assets separate from the land (s 40-30: ¶17-020).

There is a special deduction for entering into a permanent conservation covenant over land with certain deductible gift recipients (¶16-972). Primary production losses may be carried forward indefinitely (¶16-895). The measures that prevent a loss from non-commercial business activities being offset against other assessable income in the year in which the loss is incurred do not apply to an individual carrying on a primary production business if the income from other sources is less than \$40,000 (¶16-020).

Where an amount is derived or incurred in a foreign currency, the foreign currency conversion rules (¶23-070) and foreign exchange gains and losses provisions (¶23-075) may need to be considered.

Trading stock

As with other taxpayers, primary producers are not entitled to a deduction for the cost of trading stock until the stock is on hand (ITAA97 s 70-15; ¶16-040). For the application of this rule to expenditure incurred under live stock breeding arrangements and to certain other expenditure, such as the cost of seed for planting, see TR 93/9 noted at ¶16-040. The trading stock provisions, including the special valuation provisions for livestock are outlined at ¶9-150 to ¶9-300.

Small business entities ("SBE")

Primary producers who are small business entities (ITAA97 s 328-110) with an aggregated turnover of less than \$2m may choose, on a asset-by-asset basis, whether to claim deductions under the primary production provisions or the SBE provisions (ITAA97 s 328-175(3)). However, deductions for horticultural plants (including grapevines) are only available under the relevant primary production provisions (¶18-070), not under the SBE rules (ITAA97 s 328-175(5)). For a general outline of the SBE provisions, see Chapter 7 (¶7-001).

Capital works deductions

Where capital expenditure on a fodder storage asset (¶18-085), water facility (¶18-080) or fencing asset (¶18-090) is deductible under both capital works expenditure (ITAA97 Div 43; ¶20-470) and primary production concessions (ITAA97 Subdiv 40-F), or would be deductible under Subdiv 40-F if the asset were used for the purpose of producing assessable income, Div 43 does not apply (ITAA97 s 43-70(2)(f)(i)).

Conservation tillage offset

A 15% refundable tax offset is available for the cost of machinery used in conservation tillage farming activities, eg those involving sowing crops in ways that minimise soil disturbance. The offset is available for assets that are first used or installed ready for use in a primary production business in the period from 1 July 2012 to 30 June 2014 (¶19-135).

GST and primary production deductions

The cost of a depreciating asset and other primary production expenditure deductible under ITAA97 Div 40 (other than on a depreciating asset) is reduced by any GST input tax credits relating to the acquisition of the asset or to the expenditure (ITAA97 Subdiv 27-B). Adjustments are also required if a decreasing or an increasing adjustment is made.

Bushfires and other natural disasters

The Commissioner has issued a fact sheet (*Bushfires and small business owners*) dealing with the concessions available for small business owners affected by bushfires. Information is available on the ATO website about how primary producers affected by certain natural disasters can access farm management deposits (FMDs) (*Natural disasters*). Refer to the Natural Disasters Checklist at ¶44-130.

¶18-010 Meaning of "primary production business"

Many of the primary production concessions dealt with in this chapter are only available to taxpayers carrying on a primary production business. Thus, a shareholder in a primary production company, a salaried manager of an agricultural or pastoral property, or the owner of such a property who has leased it and/or the business to another, will not qualify as a primary producer for the purposes of the averaging provisions (¶18-200). On the other hand, the city-dwelling owner of a primary production business would qualify as a primary producer, even though the property is run by a salaried manager. The members of a partnership, or the beneficiaries entitled to the income of a trust, which carries on a primary production business would also qualify as primary producers.

A "primary production business" is defined (ITAA97 s 995-1(1)) as a business of:

- cultivating or propagating plants or fungi in any physical environment

- maintaining animals for the purpose of selling them or their bodily produce
- manufacturing dairy produce from raw material that a taxpayer has produced
- conducting operations relating directly to taking or catching fish, turtles, dugong, beche-de-mer (sea cucumbers), crustaceans or aquatic molluscs
- conducting operations relating directly to taking or culturing pearls or pearl shell
- planting or tending trees in a plantation or forest that are intended to be felled
- felling trees in a plantation or forest, or
- transporting trees, or parts of trees, felled in a plantation or forest, directly to the place where they are first to be milled or processed, or transporting them to the place from which they are to be transported to be milled or processed.

The manufacture of dairy produce qualifies as primary production provided the manufacturer was also the producer of the raw material. On the other hand, timber milling is not primary production even though the miller may have planted, tended and felled the trees.

Primary production includes contract broiler growing (IT 233), prawn farming and the provision of artificial breeding services for the beef cattle industry by selling semen collected from bulls owned and maintained by the taxpayer (IT 219). However, the following activities are *not* regarded as primary production activities: kelp harvesting (IT 2006); beach worming (TD 93/39); and live sheep export (TD 93/94; TD 93/95). A cattle dealer would not usually be a primary producer.

[FTR ¶355-005]

¶18-020 Carrying on a primary production business

Whether or not a taxpayer's activities amount to carrying on a *business* of primary production is "a question of fact and degree" — this is judicial code for "often it's very hard to tell". A person can obtain a private ruling on "ultimate conclusions of fact" such as on the question of whether a business is being carried on (TR 2006/11). Relevant indicators of a primary production business include:

- whether the activities have a significant commercial purpose or character
- the size or scale of the activities
- whether the activities result in a profit and, in those cases where no profit is produced, whether the taxpayer has a genuine belief that eventually the activities will be profitable
- whether the activities are of the same kind or carried on in the same way as those which are characteristic of ordinary trade in the line of business in which the venture was made
- whether there is repetition and regularity of the activities
- whether the activities are conducted in a systematic and businesslike manner
- whether the taxpayer has had prior experience in related business activities
- whether the activities may more properly be described as the pursuit of a hobby or recreation rather than a business (¶10-105).

There is often a significant overlap between these indicators and no individual indicator should be regarded as decisive. In addition, the weighting to be given to each indicator will vary from case-to-case (TR 97/11).

For example, the scale of activities is important but not determinative. A person may carry on a business, if only in a small way (*Thomas*). In one case, a man was held to be carrying on a primary production business with just one goat: a female stud angora that

cost \$3,000 (*Walker*). This decision is all the more interesting because the taxpayer lived in Queensland but depastured the goat on a stud farm in Victoria. The Commissioner often argues that lack of personal involvement suggests something other than a business but, in this case, the distance between taxpayer and goat was not fatal to the claim. The fact that a taxpayer is experienced and competent in farming and has a genuine belief that the property will generate profits will indicate that a primary production business is being carried on (*Daff*). However, flower growing was not a business where the "business" premises (a hothouse) looked like a shambles, the taxpayer had never done a stocktake and there was no likelihood of breaking even for many years (*Crees*). Similarly, no business of growing palm trees was carried on where the taxpayer planted palms on a landscape, rather than a plantation, basis, and the small number of palms planted gave an insignificant potential return when compared with the cost of the land (*Reiger*).

If a business *has* started, expenses incurred in the early years of the business before any income commences to be derived may be deductible where this is a normal characteristic of the type of business (IT 2208: ¶16-154). The non-commercial loss provisions do not apply to an individual carrying on a primary production business if the assessable income from other sources is less than \$40,000 (¶16-020).

A primary production business is no longer carried on when the primary production activities have ceased, even though there may be an intention of recommencing those activities in the future (*Inglis*).

Share-farming arrangements

Under share-farming or share-cropping arrangements, a farmer is allowed to farm and harvest a crop on someone else's land in return for payment of a percentage of the harvest proceeds to the owner of the land. The owner (or lessor) will be treated as being engaged in a primary production business only if the arrangement amounts to a partnership (¶5-010) or the landowner has a direct or immediate involvement in the activities that make up the business. The payment of expenses relating to the ownership of the land would not be sufficient and any receipts from the farmer for the use of the land would be income from property rather than from carrying on a primary production business (TD 95/62).

Preparatory activities

Sometimes a taxpayer's activities do not amount to carrying on a primary production business but are merely *preparatory* to engaging in such a business. For example, steps taken by a taxpayer to clear weeds and put the land into a state of readiness were no more than preparatory to establishing an orchard (*Dalton*). In *Nelson*, the taxpayer's activities over a number of years involved extensive research and planning but they had not reached the point where they constituted a primary production business.

On the other hand, in *Ferguson*, it was held that the taxpayer's preliminary activities in building up a herd of cattle through a leasing arrangement had sufficient commercial character to amount to a business. Substantial preparatory work, which may include the propagation of plant stock or the establishment of a sheep farm from which assessable income will ultimately be generated, may nevertheless amount to the carrying on of a business (*Case T12; Case 75/96*).

Although a taxpayer engaged in preparatory work may be regarded as carrying on a primary production business in appropriate cases, expenditure is not deductible under the general deduction provisions (¶16-010) if it is of a capital nature. Costs incurred in establishing a plantation of fruit or nut trees, at least up to the stage of getting seedlings established in the ground, would generally be non-deductible capital expenditure. On this basis, a taxpayer was denied a deduction for the cost of fertilising the soil prior to putting in chestnut trees (*Osborne*).

However, the establishment costs of new horticultural plants and grapevines (¶18-070) may be eligible for an accelerated write-off. It also seems that a person starting a business of raising *annual* crops may deduct the cost of fertiliser, even if no crop is ever harvested. Similarly, the cost of seedling trees to be used in an afforestation business is immediately deductible (TR 95/6).

Even where activities are held to be preparatory to engaging in a primary production business, depreciation may be deductible if the capital allowance provisions (¶17-000) are satisfied (*Dalton*).

Afforestation, cattle leasing and other managed investment schemes (MISs)

Participation in afforestation schemes generally takes one of two forms — an investment or a business pursuit. Where the participation is by way of investment in bonds, the expenditure so incurred is capital and not deductible (*Milne*); as is expenditure relating to the cost of research and development conducted before commencing the primary production business (*Howland-Rose*; *MacPherson (No 2)*; *Brody*; *Petersen*). Amounts outlaid in return for recurrent management services are on revenue account even if paid as a lump sum in advance (*Lau*), subject to the prepayment rules set out at ¶16-045 (¶18-125).

Investors were found to be carrying on a business in *Puzey* (sandalwood), *Iddles* (viticulture), *Sleight* (tea-trees), *Lenzo* (sandalwood), *Guest* (blueberries) and *Cooke* (horticulture). However, in the first four cases, deductions were disallowed on the basis of the general anti-avoidance provisions (¶30-170). In *Barham*, an investor in an aloe vera managed project was not carrying on a business and, in any case, due to the operation of the anti-avoidance provisions was not entitled to a deduction for management fees except to the extent that the amounts were actually paid.

See also the ATO Fact Sheet *Mass marketed investment schemes*.

Participation in a cattle or sheep leasing scheme may amount to a primary production business, even though it represents the initial stages of a long-term plan, provided the venture has a businesslike flavour, is conducted systematically and the taxpayer has the necessary funds to finance his/her participation in the scheme (IT 226; *Walker*; *Solling*; *Pepper*; *Hanlon*). Lease and management charges relating to cattle leasing schemes entered into for the purpose of upgrading the herd of an existing cattle raising business will be accepted as part of the outgoings of the existing business.

However, where the management agreement effectively guaranteed the provision by the manager of a set number of calves, as well as management services, and the taxpayer was not carrying on a business, the fees were on capital account (had the taxpayer carried on a business of breeding and selling cattle, the cattle would have been trading stock and on revenue account) (*Vincent*; ¶30-170). In another cattle breeding scheme, participants were neither considered to be carrying on a business nor undertaking a profit-making scheme (*Klein*).

Product rulings

There is a separate system of “Product Rulings” relating to promoted tax-effective investment arrangements of the kind typically associated with many afforestation and other investment schemes (¶24-540). The system gives investors access to binding public rulings on proposed schemes.

Registered agricultural managed investment schemes

Registered agricultural managed investment schemes (MIS) are registered with ASIC and they operate under the *Corporations Act 2001*. Depending on the circumstances, participants in such schemes may be carrying on a business and may be entitled to claim deductions for relevant expenses such as rent, management fees or responsible entity fees (*Hance*). Before the *Hance* decision, it was the Commissioner’s view that contributions by investors to registered agricultural MIS were capital, or of a capital nature. The Commissioner accepts *Hance* as authoritative in relation to similar

schemes (ATO *Decision Impact Statement on Hance*). The ATO has withdrawn rulings reflecting the earlier view (TR 2007/8; GSTR 2008/D1) and is issuing product rulings based on the current view.

There are specific tax concessions for forestry MISs (¶18-125).

If the responsible entity of a registered agricultural MIS changes, that does not affect the tax outcomes for participants in the scheme if it continues to be run according to the terms of a relevant product ruling (TD 2010/7). Investors in a non-forestry MIS may claim tax deductions in respect of contributions to the scheme. There is no clawback of deductions if an interest in a scheme is disposed of or terminated due to circumstances outside of the control of the investor (TD 2010/8). Payments received by an investor on the winding up of a non-forestry MIS may be assessable, depending on the circumstances (TD 2010/9).

[FITR ¶355-007 – ¶355-015]

¶18-030 What is income from primary production?

For a number of reasons it may be necessary to determine what constitutes income from primary production. This is relevant mainly for the purpose of the averaging provisions, which require a primary producer’s “taxable primary production income” and “taxable non-primary production income” to be separately identified (¶18-210). Some common items of primary production income are:

- proceeds from the sale of produce
- proceeds from the sale of skins and hides
- profits on the sale of live stock
- insurance payments for loss of profits
- assessable balancing adjustments from the disposal of depreciating assets
- income from the short-term hiring of equipment to other primary producers or the granting of short-term agistment rights (but not where a substantial part of the property is used solely for agistment).

Guidelines on the tax treatment of income from particular activities

• **Cotton.** Cottongrowers derive income under a cotton contract when property in the cotton has passed from the grower to the merchant and a debt for an ascertainable sum has been created. Where cotton is placed in a pool, income is derived under the pool contract that provides for when a debt will become due and owing to the grower. A non-repayable advance distribution by the merchant to the grower is derived in the year in which the merchant declares or approves the distribution of a certain amount. In the case of fixed price and guaranteed minimum price pools, income is derived by the grower at the time of classing, which is completed within 14 days of ginning. Distributions in excess of the minimum guaranteed price are assessable to the growers when declared by the merchant (TR 94/13).

• **Dairy.** Dairy Regional Assistance Program grants are assessable (ID 2002/784). Dividends received by a dairy farmer on shares compulsorily held in a dairy cooperative are assessable primary production income (ID 2010/149).

• **Equine influenza hardship assistance.** Equine Influenza Hardship Wage Supplement Payments, Commercial Horse Assistance Payments (CR 2008/59) and Equine Influenza Business Assistance Grants are taxable. Equine Influenza Hardship Grants are not taxable. Grants for non-government not-for-profit equestrian organisations who have incurred expenses directly related to the outbreak are taxable unless the organisation is tax-exempt.

• **Fishing.** For the taxation treatment of payments made under the Securing our Fishing Future Package and similar entitlements, see CR 2007/47, CR 2007/49, CR 2007/64, CR 2007/65, CR 2007/72 and CR 2007/101.

• **Forest operations.** Receipts that may constitute assessable income from forest operations include proceeds from the sale of felled or standing timber, the royalties from granting rights to others to fell and remove timber, insurance recoveries and reforestation incentive grants or payments (TR 95/6). For the market value of matured trees ventured into a new business of forest operations, see TD 96/8.

• **Government payments to industry.** A government payment made to assist a business to continue operating is included in the assessable income of the recipient under s 6-5 or s 15-10. A payment to industry to commence or cease a business or for agreeing to give up or sell part of the profit-yielding structure is not assessable (TR 2006/3). For example, an exceptional circumstances relief payment (ECRP) paid to a farmer under the *Farm Household Support Act 1992* is not primary production income (TD 2008/16). Exit Assistance Program grants are not assessable income if the grant requires the taxpayer to transfer ownership of all their irrigated land and, as a result, the taxpayer's farming business ceases (¶10-160). A payment to a farmer under the Namoi River Groundwater Structural Adjustment Program, described as "financial assistance to help licence holders adjust to changes in groundwater access", was not liable to income tax (*Carberry*). The Commissioner considers that a GSAP payment may be income if the recipient completes all of the steps in the program (ATO *Decision Impact Statement on Carberry*).

• **Grazing/conservation payments.** Stewardship and on-ground works payments received under certain conservation programs are assessable, for example: on-ground establishment works payments and ongoing conservation management payments to landholders under the Western Catchment Management Authority's Enterprise Based Conservation Program (CR 2007/92); payments received under the Lower Murray Darling Catchment Management Authority Rangelands Incentive Strategy — Conservation Reserves and Sustainable Grazing Schemes (CR 2007/87); and conservation management payments under Murrumbidgee Catchment Management Authority EcoTender programs (CR 2010/1; CR 2010/76).

• **Hedging contracts on futures markets.** Income from hedging contracts on futures markets entered into by primary producers may be regarded as income from primary production. As a general rule, a sale of a futures contract by a primary producer for hedging purposes is an integral part of the primary production business where the quantity of goods specified in the contract corresponds to the estimated production and where there is a subsequent sale of goods of the kind covered by the contract. Where, as in a normal hedging operation, the futures contract is terminated by a subsequent buy-back contract, the resulting profit or loss will be accepted as arising from the primary production business (IT 2228).

• **Horses.** The taxation issues arising from horse breeding, racing and training are outlined in TR 2008/2. See also TR 93/26 (tax treatment of stallion syndicates). For the circumstances in which the activities qualify as a primary production business, see TR 97/11.

• **Interest and dividends.** Interest on a primary producer's term deposit account opened as a condition of obtaining finance to purchase a new farming property was held to be assessable income from primary production and, therefore, income subject to averaging (*Case X82*). Special dividends received by a primary production partnership from the purchaser of its produce are included in assessable primary production income (ID 2002/773).

• **Sugar.** Exit grants previously paid under the Sugar Industry Reform Program, which operated between 1 February 2003 and 30 June 2007, were exempt from income tax under former s 15-65 of ITAA97, provided certain conditions were met. If the recipient, however, repays the exit grant upon re-entry into the industry, the repayment is excluded from assessable income under s 59-30.

• **Tobacco.** Grants in 2006/07 and in later income years under the Tobacco Growers Adjustment Assistance Programme 2006 to tobacco growers who undertake to exit all agricultural enterprises for at least five years are exempt (s 53-10; 118-37). See also CR 2007/99.

• **Victorian bushfire grants.** Clean-up and Restoration Grants paid in the 2008/09 and 2009/10 income years to small businesses and primary producers affected by the February 2009 Victorian bushfires were non-assessable non-exempt income (former ITAA97 s 59-50).

• **Water entitlements.** Generally, receiving a lump sum for a permanent sale or disposal of water entitlements would not be an ordinary incident of a primary production business (the assessability of such amount depends on the surrounding facts). There may be income or CGT consequences from the receipt of government compensation for the reduction or cancellation of water entitlements. The ATO website contains information about the taxation of water entitlements in the *Landcare and water* chapter of its guide for primary producers *Primary producers essentials*. CGT roll-over relief is available for taxpayers who replace an entitlement to water with one or more different entitlements (¶12-445). For the taxation consequences of certain water entitlements, see CR 2008/28 (replacement of bore licence with aquifer access licence).

• **Sustainable Rural Water Use and Infrastructure Program.** The SRWUIP is a Commonwealth program to provide funding for projects to increase efficient water use in rural Australia. SRWUIP payments are generally taxable in the year they are received, either as ordinary income or as a subsidy, or as capital gains, to the extent that the payment is consideration for surrendered water rights (¶10-160). Expenditure under the program may be deductible over three years, as water facilities used in primary production. For SRWUIP payments made on or after 1 April 2010, taxpayers can choose either the existing tax treatment of payments and related expenditure or to make payments non-assessable non-exempt (NANE) income and to disregard any capital gain or loss from transferring the water rights. If they do, expenditure related to the payments is not deductible and does not form part of the cost of any asset it is spent on. The ATO has administrative arrangements for assessing tax returns lodged for the period from 1 April 2010, including returns that anticipate the changes.

• **Wheat and barley.** For growers returning their income on an accruals basis, gross amounts from the sale of wheat or grain to the Australian Wheat Board for cash or at a previously agreed price are included in assessable income in the income year in which they sell the wheat or grain. For growers returning their income on a cash basis, gross amounts from the sale of wheat or grain are included in assessable income in the year in which they receive the payment (TR 2001/1). Similar rules apply where growers receive amounts from the sale of barley, grain or other commodities to the Australian Barley Board (TR 2001/5). See also CR 2004/122 to CR 2004/124. For the deductibility of certain underwriting fees payable to the Wheat Board and to the Barley Board under harvest payment agreements, see TD 2002/18.

• **Wind farming income.** The Commissioner considers that ordinary income earned by an individual from allowing wind farming infrastructure to be built and operated on farmland is not "assessable primary production income" for the purposes of ITAA97 Div 392 (TD 2013/2).

• **Wool.** The position of a woolgrower who returns income on an accruals basis is dealt with in TR 97/9. Woolgrowers returning income on the accruals basis derive income when all obligations necessary under a sale of wool contract have been performed

to create an entitlement to the payment of an ascertainable sum. In an auction, income is derived when the property passes to the buyer at the fall of the hammer. At this time the wool ceases to be trading stock of the woolgrower. In sales by forward contracts, income is derived when the buyer, having taken delivery of the wool, receives the results of testing. In the case of sales of pooled wool, payments made in advance of the final payment are usually income when the pool operator declares them. For the final payment, income is derived when the grower becomes contractually entitled to it.

[FITR ¶27-380]

Special Deductions for Capital Expenditure

¶18-050 Special capital expenditure deductions

Concessional tax treatment is given to capital expenditure relating to telephone lines (¶18-060), horticultural plants and new grapevines (¶18-070), water facilities (¶18-080), fodder storage assets (¶18-085), fencing assets (¶18-090), landcare operations (¶18-100) and timber depletion (¶18-120).

Generally, the amount of the deduction excludes the amount of any input tax credit to which the taxpayer may be entitled. Decreasing adjustments are included in assessable income and increasing adjustments are deductible (ITAA97 s 27-105).

A 15% refundable tax offset for the cost of machinery used in conservation tillage farming activities, eg those involving sowing crops in ways that minimise soil disturbance, was available in the period from 1 July 2012 to 30 June 2014 (¶19-135).

Where a commercial debt is forgiven, the debtor's deduction under the capital allowance provisions in ITAA97 Div 40 may be reduced under the rules outlined at ¶16-910. Special provisions apply if property is acquired under limited recourse finance and the debt is terminated before full repayment (¶23-260).

If an entity joins or leaves a consolidated group under the consolidation regime (¶8-000), any deduction under the primary production provisions (other than for the decline in value of depreciating assets) is allocated between the two entities (ITA 97 s 716-25; 716-70: ¶8-580). Special rules apply for depreciating assets.

The primary production deductions are subject to the rules for tax-preferred leasing provisions outlined at ¶23-210.

Special rules for partnerships

If the expenditure relating to some of the above items is incurred by a partnership, it is not deductible in arriving at the net income or loss of the partnership. Instead, each partner is treated as having personally incurred a part of the cost and is entitled to claim deductions based on that part. If the partners have not agreed on the share of the cost each will bear, the total cost is divided between them in the same ratio as their respective interests in the net partnership income or loss (¶5-130) of that year.

Non-arm's length dealings

Where the expenditure is incurred under a "non-arm's length dealing" and exceeds the "market value" (¶17-045, ¶17-050) of what the expenditure is for, only that market value is taken into account in calculating the deduction.

¶18-060 Telephone lines

The capital cost of a telephone line extending to, or situated on, land being used for a primary production business may, to the extent that it is not otherwise deductible, be written off in equal instalments over a 10-year period (ITAA97 s 40-645; 40-650).

To qualify for this special deduction, the expenditure must have been incurred by: (a) the owner of the land or some other person (eg a tenant or lessee) having an interest in the land on which a primary production business was at that time being carried on (not necessarily by the claimant for the deduction); or (b) a sharefarmer carrying on a primary production business on that land.

Once the cost of a telephone line has qualified for deduction, it cannot be, or form part of, a deduction under any other provision of the income tax laws, whether in the hands of the taxpayer who incurred the expenditure or any other taxpayer. For example, there is no deduction for depreciation under the general capital allowance rules in Chapter 17.

The ordinary CGT rules (rather than CGT event K7) apply where the asset is subject to a CGT event such as a disposal (ITAA97 s 104-235; 118-24).

Special rules apply if the expenditure is incurred by a partnership or in a non-arm's length dealing or if a commercial debt is forgiven (¶18-050). Recoupments of the telephone line expenditure are assessable (¶10-270).

[FITR ¶88-325, ¶88-330]

¶18-070 Horticultural plants

Capital expenditure incurred in establishing horticultural plants may be written off where the plants are used, or held ready for use, in a business of horticulture (ITAA97 s 40-515 to 40-575). Total deductions cannot exceed the capital expenditure incurred on the plant.

A "horticultural plant" is a depreciating asset and is defined to mean any live plant or fungus that is cultivated or propagated for any of its products or parts.

The deduction is available where one of the following ownership conditions is satisfied:

- the taxpayer owns the plant and any holder of a lesser interest in the land (eg licensee or lessee) does not carry on a business of horticulture on the land
- the plant is attached to land held under a lease or under a quasi-ownership right granted by an exempt Australian or foreign government agency and the lease or right enables the taxpayer to carry on a business of horticulture on the land (and any holder of lesser interests does not carry on such business on the land), or
- the taxpayer holds a licence relating to the land to which the plant is attached and carries on a business of horticulture on the land.

In addition, the taxpayer must use the plant or hold it ready for use for commercial horticulture (ie for the purpose of producing assessable income in a business of horticulture).

Eligible expenditure

The cost of establishing horticultural plants may include the cost of: (a) acquiring and planting the plants or seeds; (b) preparing to plant (but not the initial clearing of land, although it may cover costs of top soil enhancement, soil analysis tests, forming up planting rows, planting site surveys, ploughing, contouring, top dressing, fertilising and stone removal that are attributable to the establishment of the plant); (c) pots and potting mixtures; (d) grafting trees; and (e) replacing existing plants and trees because of loss of fair economic return or declining popularity of a particular variety. Establishment expenditure also includes the cost of establishing plants used for associated purposes, such as for companion planting, if those plants are not horticultural plants in their own right (TD 2006/46). The cost of maintaining an established plantation (including replacing plants because of premature death or disease) may be a revenue expenditure.

Where a taxpayer purchases plants from a nursery and the plants are maintained by the nursery until an agreed delivery date, the total costs, including the maintenance costs, are of a capital nature (TD 2006/46).

Establishment expenditure does not include the cost of draining swamp or low-lying land or clearing land. Further, it excludes expenditure that is part of a pool of construction expenditure on capital works (¶20-470) as well as the cost of the land on which the plants are situated.

A taxpayer can get a deduction for the establishment expenditure even if it was incurred by a previous owner of the plant. If the ownership of a plant is transferred, the transferor may be required to give the transferee information that will help the transferee calculate the deduction. The ordinary CGT rules (rather than CGT event K7) apply if the plant is subject to a CGT event such as a disposal (ITAA97 s 104-235; 118-24).

For the first taxpayer to satisfy the ownership conditions, the plant starts to decline in value in the income year in which its first commercial season starts. For later taxpayers, the plant starts to decline in value in the later of: (a) the income year in which the taxpayer first satisfied the ownership conditions; and (b) the income year in which the first commercial season starts.

If the effective life of a plant is less than three years, a taxpayer can get a deduction for 100% of the establishment expenditure in the year in which the plant starts to decline in value. If the effective life of a plant is three or more years, the taxpayer can get an annual deduction during the plant's "maximum write-off period", that is, the period beginning at the time when the plant first became capable of being used for commercial horticulture.

As a horticultural plant is a depreciating asset, its effective life is measured in accordance with the general rules for determining the effective life of depreciating assets (¶17-270). The taxpayer can self-assess the effective life or rely on the Commissioner's determination. The Commissioner's current determinations for specified plants are set out at ¶43-010. Where the plant is destroyed before the end of its maximum write-off period, a special deduction is available for the unrecouped expenditure relating to the plant as reduced by any amount received for the destruction, eg insurance proceeds (s 40-565).

Calculation of write-off

The deduction allowed for the decline in value of the plant is worked out using the following formula:

$$\text{establishment expenditure} \times \frac{\text{write-off days in income year}}{365} \times \text{write-off rate}$$

The "write-off days in income year" are essentially the days in a year: (a) on which the taxpayer used the plant or held it in readiness for use for commercial horticulture; (b) on which the taxpayer satisfied the ownership conditions (see above); and (c) within the maximum write-off period for the plant. The following table is used to work out the "write-off rate" and the maximum write-off period for a plant.

Years in effective life of plant	Annual write-off rate	Maximum write-off period
3 to fewer than 5	40%	2 years and 183 days
5 to fewer than 6 ² / ₃	27%	3 years and 257 days
6 ² / ₃ to fewer than 10	20%	5 years
10 to fewer than 13	17%	5 years and 323 days
13 to fewer than 30	13%	7 years and 253 days
30 or more	7%	14 years and 105 days

► Example

Thornbeauty Pty Ltd spent \$200,000 to establish a commercial rose garden of 11,200 plants. When the plants entered their first commercial season at the start of September in Year 1, there were only 10,000 viable rose bushes remaining. At this time, the effective life of the rose bushes was estimated at seven years.

Assuming none of the remaining 10,000 rose bushes are destroyed before the end of the maximum write-off period of five years, the annual deductions for Thornbeauty (or a subsequent owner) are calculated on the basis of the formula:

$$\text{establishment expenditure} \times \frac{\text{write-off days in income year}}{365} \times \text{write-off rate}$$

Thus, the deduction allowable in Year 1 is:

$$\$200,000 \times \frac{303}{365} \times 0.20 = \$33,206$$

The deductions available in the following years (ignoring leap years) are:

- In each of Years 2, 3, 4 and 5:

$$\$200,000 \times \frac{365}{365} \times 0.20 = \$40,000$$

- In Year 6:

$$\$200,000 \times \frac{62}{365} \times 0.20 = \$6,794$$

Other aspects

The rules about partnerships, non-arm's length dealings and commercial debt forgiveness referred to in ¶18-050 and the tax-preferred leasing rules outlined at ¶23-210 apply to expenditure on horticultural plants. Recoupments of establishment expenditure are assessable (¶10-270).

The rules for depreciating horticultural plants in Subdiv 40-F apply to expenditure incurred on or after 1 July 2001. Under transitional provisions, unrecouped expenditure on pre-1 July 2001 horticultural plants continues to be deductible under Subdiv 40-F, using the same establishment expenditure and the same effective life (ITTPA s 40-515).

The cost of establishing grapevines before 1 October 2004 was subject to a special four-year write-off (former s 40-550). The cost of establishing grapevines on or after 1 October 2004 is written off under the horticultural plants provisions. The Commissioner has determined the effective life of grapevines to be 15 years (dried and table) and 20 years (wine). For information on the former four-year write-off for grapevines, see the 45th edition of the *Australian Master Tax Guide* and earlier editions.

[FITR ¶87-970 – ¶88-095]

¶18-080 Water facilities

Capital expenditure on water facilities for primary production land may qualify for an immediate deduction where it is incurred after 7.30 pm on 12 May 2015 (ITAA97 s 40-515 to 40-575). Expenditure incurred before that (but after 1 July 2004) will qualify for deduction spread over three years.

For the deduction to apply, the following conditions must be satisfied:

- (1) the taxpayer must incur capital expenditure on the construction, manufacture, installation or acquisition of a depreciating asset that is a water facility

- (2) the expenditure must be incurred primarily and principally to conserve or convey water, and
- (3) the water must be for use:
 - in a primary production business conducted by the taxpayer on land in Australia, or
 - if the expenditure is incurred by an irrigation water provider, the water must be for use in primary production businesses conducted by other entities on land in Australia, to whom water is supplied by the irrigation water provider.

“Water facility”

A water facility means:

- plant (¶17-040) or a structural improvement that is primarily and principally for the purpose of conserving or conveying water, eg a dam, tank, tank stand, bore, well, irrigation channel, pipe, pump, water tower, or windmill
- a structural improvement that is reasonably incidental to conserving or conveying water, eg a culvert, fence to prevent livestock entering an irrigation channel, or bridge over an irrigation channel, or
- alterations, additions, extensions or (from 1 July 2004) capital repairs to any of those assets.

The deduction would extend to the construction of power lines from an existing mains electricity connection to plant used for water conservation or conveyance (IT 252). It would not extend to the initial connection of mains electricity or upgrading an existing connection, but those costs may be deductible under other provisions (¶16-820).

A water facility would not include a water access entitlement. The cost of this also would not be deductible as a business deduction (ID 2004/392). However, it has been held that a levy paid by a canegrower to a weir construction co-operative was deductible in full as a business expense (*McLennan*).

Expenditure on long-lasting trickle irrigation systems would qualify for the water facilities deduction. The cost of lightweight systems that rest on the surface and are dug in each year would probably qualify for outright deductions as a business expense (IT 2339).

It is not necessary that the water facility be on the land on which the primary production business is carried on. For example, the deduction would apply to expenditure on the installation of a pump and piping on Crown land for the purpose of conveying water to land where the primary production business is being conducted.

Eligible purpose

The requirement that the expenditure be incurred “primarily and principally” for the purpose of conserving or conveying water means that this purpose must outweigh the total of all other ineligible purposes.

The ATO considers that this is an objective test that requires an examination of the “primary and principal function or purpose of the result” produced by incurring the expenditure. Subjective factors are not taken into account (TD 94/9). For example, the installation of a new watering system would be covered irrespective of the subjective reason for the particular choice of system used.

This requirement is also designed to ensure that the three-year water facilities deduction and the outright deduction available for landcare operations (¶18-100) are mutually exclusive.

► Example

The taxpayer incurs expenditure on constructing a dam primarily and principally for the purpose of holding water for irrigation. The dam also serves, to some degree, as a retention dam to prevent excessive water run-off that could lead to soil erosion. The expenditure is properly deductible over three years as a water facility expenditure rather than as a cost of landcare operation.

As long as the requisite purpose exists, it is irrelevant if, for example, a bore or well actually fails to produce the required quality or quantity of water (TD 96/41).

The installation costs of an in-ground swimming pool would not be eligible, even though the pool may occasionally be used to draw water for fire-fighting purposes. However, if the pool was equipped with an extra pump to be used solely for fire-fighting purposes, the cost of that pump would qualify (TD 92/190).

Other conditions and rules

If one taxpayer has already been eligible for a water facilities deduction for the acquisition, construction or manufacture of the facility, another taxpayer cannot claim the water facilities deduction for the cost of subsequently acquiring the facility (s 40-555).

► Example

A taxpayer buys second-hand commercial irrigation equipment that, presumably, has previously been used on primary production land. The water facilities deduction would not be available, as the ATO would assume that the previous owner would have been entitled to such a deduction. The ATO considers that the onus is on the purchaser to show on the balance of probabilities that such an entitlement did not in fact arise. (Based on ID 2004/15.)

In this example, however, the purchaser could claim the water facilities deduction for its own capital expenditure in installing the equipment, as distinct from acquiring it.

Similarly, the purchaser of primary production land cannot claim a deduction for that part of the purchase price attributable to water tanks, bores or other improvements for conserving or conveying water (*Case W9*; TD 96/40).

The ordinary CGT rules (rather than CGT event K7) apply if the water facility is subject to a CGT event such as a disposal (ITAA97 s 104-235; 118-24). If the land and the facility are sold, the former owner can continue to claim the deduction provided the facility is still wholly being used for a taxable purpose or in carrying on a primary production business (ID 2004/689).

The rules that apply to expenditure incurred by partnerships, to expenditure under non-arm's length dealings and to the forgiveness of commercial debts are referred to at ¶18-050. The deduction is also subject to the rules for tax-preferred leasing provisions outlined at ¶23-210. Recoupments of water conservation expenditure are assessable (¶10-270). See ID 2007/36 and ID 2007/37 for the interaction with Div 58 (assets previously owned by exempt entities) and with the consolidation provisions respectively.

[FITR ¶87-970 – ¶88-090]

¶18-085 Fodder storage assets

Primary producers may deduct expenditure on fodder storage assets over three income years, with effect from 12 May 2015 (ITAA97 s 40-515 to 40-575). One-third of the expenditure is deductible in the income year in which it is incurred and one-third in each of the following two years. The total deduction over the three income years cannot be more than the amount of capital expenditure.

The deduction applies to capital expenditure incurred on the construction, manufacture, installation or acquisition of a fodder storage asset if that expenditure was incurred *primarily and principally* for use in a primary production business conducted on land in Australia.

A “fodder storage asset” is defined as an asset that is primarily and principally for the purpose of storing fodder. A fodder storage asset is also a structural improvement, a repair of a capital nature, or an alteration, addition or extension, to an asset or structural

The information about the transaction must relate to the identification, collection or recovery of a possible tax-related liability of the other entities involved in the transaction and may relate to the identification of those other entities. Any possible tax exemption is disregarded as reporting entities may not know whether the entity they are reporting on is exempt from a taxation law.

An administrative penalty may apply under TAA Sch 1 s 284-75 to any false or misleading statements made in reporting.

Exemptions from third party reporting

Certain classes of electronic payment system transactions and other transactions have been exempted from the third party reporting regime:

- administrators of a payment system are not required to report payments processed by Bulk Electronic Clearing System Framework Participants and payments processed by New Payment Platform Participants for 2017/18 (*Legislative Instrument F2016L00530*)
- administrators of a payment system are not required to report: payments made to a carriage service provider; payments made to a utility for the provision of electricity, water, sewerage or gas; payments made to a government-related entity; payments made to a general insurer, life insurer or private health insurer which are received in the course of the insurer's insurance business; payments made to a superannuation fund, approved deposit fund, pooled superannuation trust or retirement savings account provider; and payments processed by High Value Clearing System Framework Participants (*Legislative Instrument F2016L00527*) and
- government related entities are not required to report: electronic payments made to a BPAY biller, by recurring direct debit, by debit or credit card payment through a merchant acquiring system or via third party payment processors facilitating any of the above payments; provision of consideration to a carriage service provider for a carriage service; provision of consideration to a utility for the provision of electricity, water, sewerage or gas; provision of consideration for transportation of employees; provision of consideration to a general insurer for services provided in the course of the insurer's insurance business; provision of consideration for accommodation in commercial premises, a hotel, motel, inn, hostel, boarding house, caravan park or camping ground; provision of consideration for the lease of goods; provision of consideration for the creation, grant, transfer, assignment or use under licence of a right; provision of consideration for a financial supply; provision of consideration for membership of a professional association or body; provision of consideration for services relating to the exercise of court or tribunal functions; provision of consideration for a supply to another government related entity; or provision of a grant to another government related entity (*Legislative Instrument F2016L00526*).

Commencement date

Third party reporting obligations in relation to transfers of real property (reported by states and territories) and ASIC market integrity data (reported by ASIC) apply to transactions happening on or after 1 July 2016. All other third party reporting obligations apply to transactions happening on or after 1 July 2017.

Chapter 34 Goods and Services Tax



Access additional tools & resources

Visit: www.wolterskluwer.cch.com.au/cchiknow

Search: *Goods and Services Tax*

	Para
INTRODUCTION TO GST	
What is GST?	34-000
A 10-point guide to GST	34-010
HOW GST OPERATES	
Registration for GST	34-100
Taxable supplies	34-105
Input tax credits	34-110
GST turnover	34-115
GST tax periods	34-120
Basis of GST accounting	34-130
GST tax invoices	34-140
GST adjustments	34-145
GST returns, payments and refunds	34-150
Non-taxable supplies	34-160
GST-free supplies	34-165
Input taxed supplies	34-170
GST SPECIAL RULES	
GST and charities and non-profit bodies	34-175
GST groups and joint ventures	34-180
Financial supplies	34-190
GST and superannuation funds	34-200
Insurance	34-210
Vehicles	34-220
Real property	34-230
Buying and selling a business	34-240
Importations	34-250
Second-hand goods	34-260
Other GST special rules and situations	34-270

GST TRANSITIONAL AND RELATED MATTERS

	Para
General GST transitional rules	34-300
Transitional rules for particular transactions	34-310
Transitional rules for pre-8 July 1999 contracts	34-320
Other GST transitional rules	34-340
Other GST-related measures	34-360

Introduction to GST**¶34-000 What is GST?**

A 10% goods and services tax (GST) started full operation in Australia on 1 July 2000. GST is an indirect, broad-based consumption tax.

- *Indirect* means that it is levied on the supply of goods, services or activities, rather than directly on income. Other indirect taxes include stamp duty.
- A *broad-based* tax applies generally to all transactions by all types of taxpayers, with only limited exceptions. It can be contrasted with taxes such as sales tax, which was generally limited to transactions involving sales, and transactions involving certain types of goods.
- *Consumption tax* means that instead of being applied to income (as measured by the amounts that are received), GST is applied to consumption (as measured by the amounts that are spent). The tax is ultimately borne by consumers, not by producers or suppliers.

GST is similar to taxes known in other countries as value-added taxes. “Value-added” means that the net tax payable at any one stage is based on the increase in the price.

Despite its name, GST is not limited to “goods and services” in the normally understood sense. For example, it also applies to real property and the creation of rights. GST is therefore a convenient but not an entirely accurate shorthand term.

GST is governed principally by the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act). All section or Division references in this chapter are to this Act unless otherwise stated. For details of other GST-related legislation, see ¶34-360.

GST applies where an entity makes a “taxable supply” (Div 7). For there to be a taxable supply, the entity — called the “supplier” — must be registered or required to be registered (¶34-100). In addition, the supply must be connected with Australia and made for consideration in the course or furtherance of an enterprise that the supplier carries on. The requirements of a taxable supply are discussed at ¶34-105. GST also applies to “taxable importations”. However, in such cases, it is the importer, rather than the supplier, which is required to account for the GST (¶34-250).

It should be noted that from 1 July 2015, the term “indirect tax zone” (s 195-1) replaced the term “Australia” in nearly all instances in the GST Act, without significant alteration in meaning. However, for simplicity, this commentary continues to use the term “Australia”.

The amount of GST that an entity is liable to pay is 10% of the value of the taxable supply (s 9-70). In effect, this means that 1/11th of the consideration received by a supplier will be regarded as being the GST on the supply. Legal liability for the GST rests with the supplier (s 9-40).

If an entity *acquires* goods or services for a “creditable purpose” (ie in carrying on its enterprise), it can claim a credit for the GST component of the price (¶34-110). This is called an input tax credit because it is a credit on business inputs. For this to apply, the entity — called the “recipient” — must be registered, or required to be registered (¶34-100) and provide, or be liable to provide, consideration for the acquisition. Also, the supply to the recipient must be a taxable supply (Div 11; ¶34-110).

The combined effect of these rules is that the ultimate burden of the GST will normally fall on the end-user or private consumer. The businesses that form part of the chain of supply act as progressive collectors of the tax, but do not ultimately bear the burden of it.

The following example gives an idea of how GST is accounted for at the various stages of production.

▶ Example

A customer buys a leather briefcase from a retailer. The retailer had acquired the briefcase from a leathersgoods manufacturer that had acquired the leather to make the briefcase from a tannery. The tannery had bought cow hide from an abattoir to make the leather. Assume that all parties are registered except for the customer. The GST rules apply as follows:

- (1) The abattoir sells the cow hide to the tannery for \$22 (including \$2 GST). When the abattoir fills in its GST return, it takes the GST it collected on its sale to the tannery (\$2), subtracts any GST it paid for input (its input tax credit, in this case assume nil) and sends the net amount (\$2) to the ATO.
- (2) The tannery processes the cow hide into leather and sells it to the leathersgoods manufacturer for \$44 (including \$4 GST). When the tannery fills in its GST return, it takes the GST it collected on its sale to the manufacturer (\$4), subtracts the GST it paid on its inputs (\$2 paid to the abattoir on purchase of the cow hide) and sends the net amount (\$2) to the ATO. The ATO has therefore collected \$4 in total so far.
- (3) The leathersgoods manufacturer makes the leather into a briefcase that it sells to a retailer for \$88 (including \$8 GST). When the manufacturer fills in its GST return, it takes the GST it collected from the retailer (\$8), subtracts the GST it paid on its inputs (\$4 paid to the tannery) and sends the net amount (\$4) to the ATO. The ATO has therefore collected \$8 in total so far.
- (4) The retailer sells the briefcase to the final consumer for \$110 (including \$10 GST). When the retailer fills in its GST return, it takes the GST it collected on the sale to the consumer (\$10), subtracts the GST it paid on its inputs (\$8 paid to the manufacturer) and sends the difference (\$2) to the ATO. The ATO has therefore collected \$10 in total.

This means that the total GST payable on the briefcase was \$10, which was the total amount sent to the ATO. It is also clear that the businesses did not ultimately bear the GST — this was totally borne by the final customer as part of the price paid.

¶34-010 A 10-point guide to GST

Below is a 10-point *simplified* snapshot of how GST works. Each of these steps is explained later in this chapter.

- (1) **GST liability.** Liability for GST arises where a registered business makes taxable supplies to its customers. The GST is imposed at the rate of 10%. Typically, it is included in the price paid by the recipient of the goods and services. The supplier must account for the amount of GST to the ATO (¶34-105).
- (2) **Getting credits for GST.** If the recipient of goods or services is a registered business entity, it will normally be able to claim a credit for the amount of GST it has paid, provided it holds a tax invoice. This credit — called an input tax credit — is offset against any GST on goods or services that the recipient supplies to its own customers (¶34-110, ¶34-140).
- (3) **Burden on end-consumer.** The net effect is that registered business entities receive an amount representing GST but do not keep it, and pay GST but get a credit for it. This means that they act essentially as collecting agents for the tax. The ultimate burden of the tax falls on the private consumer of the goods and services, as this person gets no credit for the GST they pay (¶34-110).

(4) **Registration.** Most business entities have to register for GST, although there are some exceptions. If an entity is not registered, it normally is not liable for GST and cannot claim credits for the GST it pays (¶34-100).

(5) **Returns and tax periods.** Businesses account to the ATO for the GST on the supplies they make and the credits they claim by making a GST return in their Business Activity Statement (BAS) (¶34-150). A separate GST return is made for each tax period, which may, according to the circumstances, be monthly, quarterly or — for some smaller businesses — annual. Monthly returns are compulsory in some situations, such as where GST turnover is \$20m or more (¶34-120).

(6) **Accounting basis.** GST and input tax credits are allocated to particular tax periods either on a cash basis (based on when amounts are received or paid out) or on an accruals basis (based on when invoices are sent or received). There are restrictions on who can use the cash basis (¶34-130).

(7) **Tax or refund?** If the GST allocated to a tax period is more than the credits for that period, the business is liable for the balance to the ATO. If the credits exceed the GST, the business is entitled to a credit or refund (¶34-150). Adjustments may need to be made later if there is a change of circumstances (¶34-145).

(8) **GST exemptions.** Some transactions are outside the scope of GST altogether because, for example, they are gifts, are made by unregistrable people or have no connection with Australia (¶34-160). Others are “GST-free” which means that there is no liability for GST on the supply, but the supplier can claim credits for the GST on its own related acquisitions. The main GST-free items are specified exports, health, food, education, international travel and certain charitable activities (¶34-165).

(9) **Input taxed supplies.** A small range of supplies is “input taxed”. This means that there is no liability for GST on supplies made and that the supplier cannot claim credits for the GST on its own acquisitions. The main input taxed items are financial services and the supply of residential rental premises (¶34-170).

(10) **Special rules** apply to a wide range of items including charities and non-profit bodies (¶34-175), GST groups and joint ventures (¶34-180), financial supplies (¶34-190), superannuation funds (¶34-200), insurance (¶34-210), vehicles (¶34-220), real property (¶34-230), buying and selling a business (¶34-240), importations (¶34-250), and second-hand goods (¶34-260). Other special rules are noted at ¶34-270.

How GST Operates

¶34-100 Registration for GST

Registration is fundamental to the operation of the GST system. An entity must normally be registered, or required to be registered, to be liable for GST or to claim input tax credits (Div 23). As far as registration is concerned there are:

- (1) entities that cannot be registered
- (2) entities that can be registered, but are not required to be, and
- (3) entities that are required to be registered.

An entity *cannot* be registered unless it is carrying on an enterprise (see below), or is intending to do so from a particular date (s 23-10).

An entity *can* be registered if it is carrying on an enterprise, or is intending to do so from a particular date (s 23-10). Non-residents as well as residents are eligible.

An entity is *required* to be registered if it is carrying on an enterprise, and its GST turnover is \$75,000 or more (s 23-5). This is called the registration turnover threshold (s 23-15). For non-profit bodies (including body corporate entities: ID 2016/1), the corresponding threshold is generally \$150,000. For the calculation of GST turnover, see ¶34-115.

If an entity is required to register, but fails to do so, it becomes liable for penalties and even prosecution.

Only an “entity” can be registered for GST (s 23-5; 23-10).

Meaning of “entity”

An entity means:

- an individual
- a “body corporate”. This includes a company, building society, credit union, trade union, statutory body, strata title body corporate, municipal council, incorporated association, and certain governing bodies of various religious institutions (MT 2006/1)
- a “corporation sole”. This is a corporation consisting of one person and that person’s successors to a particular position, eg a bishopric
- a “body politic”, ie a government. Government departments are technically not entities but can be separately registered
- a partnership (see below)
- any other unincorporated association or body of persons, eg charities, clubs or certain syndicates. To qualify, something more than a common aim or purpose is necessary. Typical characteristics would include: members of the association; a contract binding the members among themselves; a constitutional arrangement for meetings of members and for appointing officers; freedom to join or leave the association; continuity of existence; and a moment in time when a number of persons combined to form the association. However, not all these characteristics are essential (*Conservative and Unionist Central Office v Burrell (Inspector of Taxes)*; MT 2006/1)
- a trust, or the trustee of the trust at any given time (see below)
- a superannuation fund, or the trustee of the fund at any given time (s 184-1).

Non-charitable public ancillary and prescribed private funds may also register and operate as enterprises for GST purposes. For the Commissioner’s guidelines on the meaning of entity, see MT 2006/1.

Types of partnership

A partnership means an association of persons carrying on business as partners (a “general law” partnership) and also an association of persons who simply are in receipt of income jointly (a “tax law” partnership). Both are registrable “entities” for GST purposes (GSTR 2003/13; GSTR 2004/6).

The ATO considers that a tax law partnership commences when the persons associate and carry on the activity from which the income will be received — this means, for example, that it can claim input tax credits on the acquisition of the property from which income may be derived jointly (GSTR 2004/6).

Trusts

Although a trust is specified as an entity (s 184-1(1)(g)), a trustee of a trust or superannuation fund is also taken to be an entity consisting of the person or persons who are the trustees at any given time (s 184-1(2)). This is stated to be because a right or obligation cannot be conferred or imposed on an entity (eg a trust) that is not a legal person (s 184-1(2); MT 2006/1).

According to the Commissioner this does not mean that the GST Act creates two separate entities — the trust and the trustee. Rather, the relevant entity is the trust with the trustee standing as that entity if legal personality is required. A consequence of this is that there will only ever be one ABN registration for the trust and only one ABN issued irrespective of the number of trustees for the trust (MT 2006/1). The ATO has stated that a public company acting as the responsible entity of a managed investment scheme is entitled to register as a trust entity (ID 2007/7).

Persons acting in different capacities

A legal person may act in more than one capacity. For example, an individual may act in his or her personal capacity, as well as in the capacity of a trustee. In such cases the person will be treated for GST purposes as a different entity in each of those capacities (s 184-1(3)).

► Example 1

Individual X and Company Y are the trustees of Z Trust. X is an entity in his or her personal capacity. Y is an entity in its capacity as a body corporate. X and Y together are an entity in their capacity as trustees of the trust.

► Example 2

An insolvency practitioner may also act as the representative of an incapacitated entity. In such a case, the same legal person is acting in two different capacities and is registered twice for GST — once as an entity pursuant to Div 58 of the GST Act and once as an entity under Div 23 of the GST Act (ID 2012/6).

Carrying on an enterprise

An entity cannot be registered unless it is carrying on an “enterprise” (s 23-5; 23-10). An enterprise is defined to mean an activity or series of activities done (s 9-20(1)):

- in the form of a business (including any profession, trade, employment, vocation or calling). The Commissioner interprets this as including business-like activities that are not carried out for profit, or non-profit clubs or associations (MT 2006/1; GSTD 2006/6)
- in the form of an adventure or concern in the nature of trade. This is intended to catch a commercial activity that does not amount to a business
- on a regular or continuous basis, in the form of a lease, licence or other grant of an interest in property. The Commissioner considers that an activity is “regular” if it is repeated at reasonably proximate intervals, and “continuous” if there is no significant cessation or interruption to the activity (MT 2006/1; GSTD 2006/6)
- by the trustee of a fund, authority or institution covered by ITAA97 Subdiv 30-B and to which deductible gifts can be made
- by the trustee of a complying superannuation fund or, if there is no trustee of the fund, by a person who manages the fund
- by a charity

- by the Commonwealth, a state or a territory (including government departments and certain local governments: GSTR 2006/5) or by a body corporate or corporation solely established for a public purpose by one of those entities
- by a non-charitable public ancillary fund or a prescribed private fund where the fund is covered by item 2 of the table in ITAA97 s 30-15 or would be covered by that item if it had an Australian Business Number (ABN).

It is not necessary that there be a series of activities. A single activity can be an enterprise.

It may also happen that a single entity carries on more than one enterprise, or carries on some activities that are an enterprise and some that are not.

► Example 3

A self-employed doctor also runs a profitable farm. The doctor is carrying on two enterprises. If the doctor registers, that will cover both enterprises.

Commencing or terminating an enterprise

An entity is treated as carrying on an enterprise if it is doing anything in the course of commencing or terminating the enterprise (s 195-1). The ATO considers that this would include conducting a feasibility study involving genuine business activities where there has been serious contemplation of developing an enterprise. However, activities undertaken to establish an entity, for example drawing up of a trust deed and the settlement of trust property (MT 2006/1), or preparatory activities (*Clayton; Guru 4U*), would not be included.

Similarly, acts done in the course of selling the business will be treated as carrying on the enterprise, for example finalising accounts, paying creditors, repaying loans, cancelling licences and business registrations (MT 2006/1); or the realisation of business assets as part of winding up a partnership (GSTR 2003/13). The ATO's view is that an enterprise would normally be taken to have terminated when all assets are disposed of or converted to another purpose, and all obligations have been satisfied (MT 2006/1).

What is *not* an enterprise

An enterprise does *not* include the following activities:

- activities carried out as an employee, or other person subject to specified PAYG withholding rules (company directors, officeholders, labour hire). This means that — subject to the special rule noted below — these people are not treated as carrying on an enterprise themselves. However, their activities are still treated as part of the enterprise of their employer or work provider
- private recreational pursuits or hobbies. These are normally characterised by their small scale, irregularity and lack of profit motive (TR 97/11; MT 2006/1)
- activities by an individual, or partnership consisting wholly or mostly of individuals, where there is no “reasonable expectation” of profit or gain. A reasonable expectation requires more than just a possibility (MT 2006/1; GSTD 2006/6). However, the fact that no profit was in fact made over a significant period does not necessarily mean that there was no reasonable expectation that a profit would eventually be made (*Case 2/2007*)
- activities by certain members of local governing bodies, for example, councillors (s 9-20(2), (4)).

A special rule applies where a person accepts a position as an officeholder in connection with other business activities. An example of this is where a partner of a legal or accounting firm becomes a director of one of the firm's client companies. Directors are generally treated as employees, so the services they provide are not normally subject to

GST. However, in this particular case, the partner/director will be treated as an enterprise, not an employee, and the supply of the partner/director's services to the company is therefore potentially subject to GST (s 9-20(2)(a)).

Meaning of "business"

The most common form of enterprise is a business. Normally there is little dispute about whether a business is being carried on. However, borderline situations arise in areas such as primary production, writing, sport or gambling. Some of the indicators used by the Commissioner are as follows. Their importance will vary in any particular situation:

- significant commercial activity
- a purpose of acting in a commercial way
- an intention to make a profit
- a reasonable prospect of profitability
- repetition or regularity of activity
- reasonable size and scale
- conformity with normal business practice
- existence of a business plan
- keeping of detailed business records
- commercial sales of product
- exercise of knowledge or skill (TR 97/11).

Activities may constitute a business even though they are only carried on in a small way. However, it would normally need to be shown that there was a real expectation of profit emerging. The ATO considers that where activities are of a very small size and scale, they would normally not be treated as a business if they are carried on in an ad hoc manner and there is little repetition or regularity (MT 2006/1).

Procedure for registration

An entity has to apply for registration within 21 days of becoming required to do so (s 25-1). Normally, this means that the entity has to apply within 21 days after the time when the enterprise it is carrying on first meets the relevant turnover threshold test (¶34-115).

If an entity is entitled to be registered, but not required to do so, it may apply for registration at any time.

Applications may be made online at the Australian Business Register (www.abr.gov.au) or by using the appropriate ABN registration form. Separate forms apply to sole traders, superannuation funds, companies and other organisations, and government bodies.

The ATO must grant an entity's application if satisfied that it is carrying on an enterprise, or intending to do so from a specified date. If the ATO is satisfied that it is required to be registered, it must register the entity even if the entity has not applied.

On registration, the ATO will notify the entity of the date of effect, the entity's GST registration number and the tax periods that apply to it (s 25-5).

Generally, the registration takes effect from the day specified in the application. This cannot be earlier than the date on which the entity commenced to carry on an enterprise. Registration may be backdated beyond the date specified in the application if the ATO is satisfied that it was required to be registered earlier. If so, the entity will be treated as

being subject to the GST system from that date (s 25-10; 25-15). However, effective for tax periods commencing on or after 1 July 2012, the Commissioner cannot backdate the registration beyond four years, unless there has been fraud or evasion (s 23-20; 25-10).

[AMGST ¶3-000; GSTG ¶5-000]

¶34-105 Taxable supplies

GST is charged or levied on the making of every "taxable supply" and "taxable importation" (s 7-1). The amount of GST that a supplier is liable to pay is 10% of the value of the taxable supply (s 9-70). In effect, this means that 1/11th of the consideration received by a supplier will be regarded as being the GST on the supply.

For an entity to make a "taxable supply" five cumulative conditions must usually be satisfied. An entity makes a "taxable supply" and therefore must charge GST if (s 9-5):

- (1) it makes a supply for consideration
- (2) the supply is made in the course or furtherance of an enterprise that it carries on
- (3) the supply is connected with Australia
- (4) the entity is either registered or required to be registered, and
- (5) the supply is not GST-free or input taxed.

It should be noted that from 1 July 2015, the term "indirect tax zone" (s 195-1) replaced the term "Australia" in nearly all instances in the GST Act, without significant alteration in meaning. However, for simplicity, this commentary continues to use the term "Australia".

There are some provisions, however, that ignore these requirements and simply deem the elements needed to create taxable supplies — for example, supplies between associates (¶34-270) and sales in satisfaction of debts (Div 105).

Offshore supplies to Australian consumers from 1 July 2017

Measures have been enacted to extend the scope of the GST to offshore supplies of services and intangibles to Australian consumers from 1 July 2017. This will result in supplies of digital products, such as streaming or downloading of movies, music, apps, games, e-books as well as other services such as consultancy and professional services receiving similar GST treatment whether they are supplied by a local or foreign supplier (*Tax and Superannuation Laws Amendment (2016 Measures No 1) Act 2016*).

"Supply for consideration"

The first requirement for a taxable supply is that an entity makes a "supply for consideration".

A supply is "any form of supply whatsoever" (s 9-10(1)) and is clearly intended to be all-encompassing, extending well beyond supplies of goods and services to include many transactions that result in an entity receiving money or property. In order to clarify the breadth of the definition, s 9-10(2) provides, without limiting the general definition in s 9-10(1), that "supply" includes any of the following:

- (a) a supply of goods
- (b) a supply of services
- (c) a provision of advice or information
- (d) a grant, assignment or surrender of real property
- (e) a creation, grant, transfer, assignment or surrender of any right
- (f) a financial supply

- (g) an entry into, or release from, an obligation:
- (i) to do anything
 - (ii) to refrain from an act, or
 - (iii) to tolerate an act or situation

(h) any combination of any two or more of the matters referred to in items (a) to (g).

Despite the breadth of this definition, it should not be automatically assumed that a supply exists and that GST consequences follow where there is a transaction and consideration is payable. Rather, it is necessary in any case where a payment is made to determine whether anything is supplied and, if so, whether the payment has a sufficient nexus to be consideration for what is supplied. The meaning of “supply for consideration” was considered by the Full Federal Court in *AP Group*. Although its comments were only obiter the court said:

“The consideration must be ‘in connection with’ the supply but the supply must also be ‘for’ the consideration . . . It ensures that not every connection between the giving of consideration and the provision satisfy the first condition of making a taxable supply. If it were otherwise, any form of connection of any character between the making of a supply and the payment of consideration would suffice.”

The meaning of “supply for consideration” is also discussed in GSTR 2014/1 in the context of motor vehicle incentive payments.

In some cases, the one consideration may be received for more than one supply (*Qantas*). In that case, the High Court held that GST was payable by an airline where a passenger books and pays for airline travel, but subsequently cancels the booking or does not turn up for the flight and does not receive a refund. The High Court said that the airline’s contractual conditions did not provide an unconditional promise to carry the passenger and baggage on a particular flight. It said the taxpayer supplied something less than that, namely (at the least) a promise to use its best endeavours to carry the passenger and baggage, having regard to the circumstances of the business operations of the airline. This was a “taxable supply” for which the consideration, being the fare, was received.

The ATO considers that a supply is normally something that passes from one entity to another (GSTR 2001/4; GSTR 2006/9).

The ATO takes the view that there may be a supply even though there is no element of consumption. On this view, agreeing to refrain from producing goods would still be a supply (GSTR 2001/4).

Prior to the High Court decision in *MBI Properties*, there was a widely accepted view that a supply cannot be “made” unless the supplier does something or takes some action (GSTR 2006/9). For example, it has been suggested that there cannot be a supply constituted by a release of an obligation that occurs independently of the act of the releasor (*Shaw v Director of Housing and State of Tasmania (No 2)*). In *MBI Properties* however, the High Court stated (at para 33) that it was incorrect to consider that the making of a supply must always involve the taking of some action on the part of the supplier. In light of this, the ATO has said that it will review GSTR 2006/9 (ATO *Decision Impact Statement*).

Compulsory acquisitions

On a similar basis, the ATO also considers that the compulsory resumption of land from an entity does not involve a “surrender” or other supply unless the entity has taken some action to cause its interest to be transferred or surrendered to the relevant authority. Accordingly, there is no supply by the entity where its legal interest is divested by operation of the resumption statute, for example, upon gazettal of the acquisition notice, and the authority initiated the resumption process pursuant to a statutory right (GSTR 2006/9; *CSR Ltd v Hornsby Shire Council*).

Supplies of money

A payment of money for the supply of something else is not a “supply” — otherwise there would be a doubling up of GST (s 9-10(4)).

However, if money is provided as consideration for the supply of other money, that will be treated as a supply. This may apply, for example, where there is a foreign exchange transaction or a cheque is cashed for a fee. This is treated as a financial supply (¶34-190).

The Commissioner considers that bitcoin is not “money” for GST purposes and that a transfer of bitcoin is a “supply” (GSTR 2014/3). The government, however, has issued a discussion paper on the GST treatment of digital currencies that considers potential changes in the GST law to remove the double taxation of digital currencies (*GST Treatment of Digital Currency, 3 May 2016*).

Commissioner’s summary of “supply” rules

The Commissioner considers that the following propositions generally apply in identifying and characterising typical two-party supplies:

- (1) for every supply there is a supplier
- (2) generally, for every supply there is a recipient and an acquisition
- (3) a supply may be mixed, composite or neither
- (4) a transaction may involve two or more supplies
- (5) to “make a supply”, an entity must do something
- (6) “supply” usually, but not necessarily, requires something to be passed from one entity to another
- (7) an entity cannot make a supply to itself
- (8) a supply cannot be made by more than one entity
- (9) creation of expectations alone does not establish a supply
- (10) it is necessary to analyse the transaction that occurs, not a transaction that might have occurred (GSTR 2006/9).

Consideration

Consideration is defined broadly and means, in effect, just about anything of value (s 9-15). In the straightforward example of a sale of goods for money, the consideration is simply the payment.

As well as payment, consideration also covers situations where someone does something or refrains from doing something. Any of these things are treated as consideration for a supply if they are:

- “in connection with” the supply (this is interpreted widely)
- made in response to the supply, or
- made to induce the supply.

It is not necessary that the consideration is provided by the recipient of the goods or services — it may be provided by a third party. Nor is it necessary that there was any legal obligation to make the payment, or that it was made to the supplier (*TT-Line Company*; GSTR 2006/9). However, in such cases, it would be necessary to establish that there is a sufficient connection between the supply and the third party payment.

“In the course or furtherance of an enterprise”

The second requirement for a taxable supply is that the supply is made “in the course or furtherance of an enterprise” that the supplier is carrying on (s 9-5).

According to the ATO, this covers any supplies that are made in connection with the enterprise. The ATO considers that the necessary relationship is established if the asset is applied, or intended to be applied, in the enterprise. This is so even if the application or intended application is minor or secondary. It is irrelevant what the recipient intends to use the asset for. It is also irrelevant, for example, whether the asset is sold or whether it is distributed “in specie” (eg where a discretionary trust makes a distribution to a beneficiary by directly transferring an asset to them). However, it would not cover the supply of private commodities, such as when a car dealer privately sells his/her own car that is not used to any extent in the business (GSTD 2009/1).

The meaning of “enterprise” is explained at ¶34-100.

“Connected with Australia”

The third requirement for a taxable supply is that the supply is connected with Australia (s 9-25). This test varies according to whether the supply is of goods, real property or other things such as services. Special rules also apply to telecommunications. For tax periods starting on or after 1 July 2015, the term “Australia” is replaced by the expression “the indirect tax zone”, without significant alteration in meaning. This is considered necessary to differentiate the territorial scope of GST from the uniform definition of Australia that applies generally for other tax purposes from that date (s 195-1).

(1) Goods

A supply of *goods* has the relevant connection with Australia in the following circumstances:

- in the case of goods supplied wholly *within* Australia, the goods have the relevant connection if they are delivered or made available in Australia. The ATO considers that this means *physically* delivered or made available (GSTR 2000/31)
- in the case of goods supplied *from* Australia, the goods have the relevant connection if they are removed from Australia (but for the exemption for exports, see ¶34-165), or
- in the case of goods supplied *to* Australia, the goods have the relevant connection if the supplier either imports the goods or installs or assembles them in Australia. The Commissioner considers that, in this context, “import” includes completing the customs formalities, for example by entering the goods for home consumption, warehousing or transshipment (GSTR 2003/15). Special rules apply to imports (¶34-250).

“Goods” include any form of tangible personal property (s 195-1). Goods therefore include trading stock, plant, equipment, food, vehicles and raw materials. Goods do *not* include real property, interests in real property, or intangible property such as contractual rights, goodwill, copyright or trademarks.

(2) Real property

A supply of *real property* has the relevant connection if the real property is situated in Australia, or if the land to which the real property relates is in Australia. “Real property” includes rights, interests, options and licences over land (s 195-1). So, for example, if an entity has a licence to occupy land situated in Australia, that licence is treated as real property which is connected with Australia.

(3) Other things

A supply of anything else (eg services, rights, advice or obligations) has the relevant connection if:

- it is done in Australia
- the supplier makes the supply through an enterprise that the supplier carries on in Australia. This means that the enterprise must be carried on through a “permanent establishment” (¶22-150), or
- there is a supply of a right or option to acquire some other thing, and the supply of that thing would be connected with Australia. This means that GST can apply to non-resident tour operators who acquire Australian package holidays from resident tour wholesalers and then on-sell them to tourists. However, it is not specifically restricted to that situation.

The Commissioner considers that, in general, the rule in (c) may be satisfied irrespective of whether the supply of that other thing is actually made. However, in the case of a *surrender* of a right or option to acquire something, the Commissioner considers that the rule in (c) will not apply. This would mean that the surrender would only be connected with Australia if (a) or (b) is satisfied (GSTR 2003/8).

Telecommunication supplies are connected with Australia if the recipient will “effectively use or enjoy them” in Australia (s 85-5).

Amendments applicable from 1 October 2016

Measures have been enacted to amend the GST law applicable to cross-border supplies involving non-resident entities with the result that certain supplies are no longer connected with Australia, or are GST-free from 1 October 2016 (*Tax and Superannuation Laws Amendment (2016 Measures No 1) Act 2016*). *Law Companion Guideline* LCG 2016/1 describes how the Commissioner will apply the new test for determining when an enterprise of an entity is carried on in Australia.

Registration

The fourth requirement for a taxable supply is that the supplier is either registered or required to be registered (s 9-5; ¶34-100).

Supplies not GST-free or input taxed

The fifth requirement is that taxable supplies do not include supplies that are GST-free or input taxed (s 9-5; 9-30). If a supply is GST-free, this means that no GST is payable on it and that the supplier is entitled to claim credits for the GST payable on its related business inputs. If a supply is input taxed, no GST is payable on the supply, but the supplier generally *cannot* claim input tax credits on its related business inputs. For details of GST-free and input taxed supplies, see ¶34-165 and ¶34-170, respectively.

A supply of a right to receive a supply that would be input taxed is itself input taxed, and the supply of a right to receive a supply that would be GST-free is itself GST-free (s 9-30).

[AMGST ¶4-000; GSTG ¶10-000]

¶34-110 Input tax credits

GST can be claimed back for any “creditable acquisition” made by an entity (s 11-20). The GST which attaches to a creditable acquisition is called an “input tax credit”.

Creditable acquisition

There are four cumulative tests that must be satisfied for an acquisition to qualify as a “creditable acquisition” and thus give rise to an input tax credit entitlement. Similar tests apply to “creditable importations” (¶34-250).