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# Australian Practical Tax Examples

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## Contents

	Page
Preface .....	vii
Wolters Kluwer Acknowledgments .....	viii
About the Author .....	ix
Abbreviations .....	xi
<b>Chapter</b>	
1 Assessable income .....	1
2 Capital gains tax .....	83
3 Fringe benefits tax .....	199
4 Deductions .....	255
5 Trading stock .....	337
6 Depreciation .....	365
7 Individuals .....	411
8 Partnerships .....	483
9 Trusts .....	511
10 Companies and distributions .....	549
11 Administration and assessment .....	607
12 Goods and services tax and other indirect taxes .....	663
Case Table .....	711
Administrative Appeals Tribunal and Taxation Board of Review	
Cases .....	717
Finding Lists .....	719
Index .....	733

## Chapter 1

# ASSESSABLE INCOME

Assessable income; royalties .....	¶1-000
Sharing economy; rental marketplace; Airbnb .....	¶1-020
Social media income; professional artist business .....	¶1-040
Disaster and relief payments .....	¶1-060
Illegal activities .....	¶1-080
Compensation for breach of business agreement .....	¶1-100
Strata title body corporate; mutuality principle .....	¶1-120
Mutuality principle; taxable income on apportionment of expenses .....	¶1-140
Excess superannuation contributions .....	¶1-160
Income or capital; mere realisation or carrying on a business .....	¶1-180
Non-cash business benefits .....	¶1-200
Lease incentive payments .....	¶1-220
Australian resident or non-resident .....	¶1-240
Residence: meaning of permanent place of abode .....	¶1-250
Source of income for resident or non-resident .....	¶1-260
Alienation of personal services income .....	¶1-280
Personal services income: unrelated clients test; personal services business .....	¶1-290
Personal services business .....	¶1-295
Allowances and reimbursements .....	¶1-300
Derivation; agreement for right to use proprietary software and related services .....	¶1-320
When is income derived; cash basis .....	¶1-340
When is income derived; accruals basis .....	¶1-360
Employee share scheme .....	¶1-380
Employee share scheme offered by start-up company .....	¶1-400
Employee share schemes: when are you genuinely restricted from immediately disposing of a share interest? .....	¶1-410
Employment termination and genuine redundancy payments .....	¶1-420
Transfer from a foreign superannuation fund .....	¶1-460
Starting a business; structuring, registrations and concessions .....	¶1-480
Image rights .....	¶1-500

## ¶1-040 Social media income; professional artist business

### Issue

Catherine Wise works full-time in sales. For the past 3 years she has pursued her hobby on weekends as a make-up artist for weddings and other special occasions. Generally, she receives tips and gifts of champagne and flowers for her services but does not include any income or deductions relating to her make-up activities in her tax return.

Catherine has gathered a following of over 200,000 people on YouTube where she posts videos on her channel showing her make-up skills. She has decided to "monetize" her channel by enabling AdSense and now earns about \$2,000 each month from this endeavour. She is ready to give up her day job and work full-time in the business.

Advise Catherine on the tax treatment of the income she has received from her social media endeavours.

### Solution

Assessable income includes income according to ordinary concepts, that is ordinary income as defined in ITAA97 s 6-5. Income received from carrying on a business is considered ordinary income.

Whether the revenue (moneys, cash) received by Catherine from her social media endeavours is income received from carrying on a business or income from a hobby is a question of fact and degree. This distinction is important because income received from pursuing a hobby is not considered assessable income.

There are no statutory rules or case law for determining whether Catherine's social media activities amount to the carrying on of a business. This new economy is yet to be tested by the courts and authorities. With the low barriers to entry for operating a business and 24/7 communications in the virtual world compared with the "old bricks and mortar" economy, a perceived hobby can factually convert into a business instantaneously. This makes it difficult to determine when the timing of the crossover from hobby to business actually occurred.

The courts, however, have developed a series of indicators that can be applied to help determine whether a business is being carried on (*Taxation Ruling TR 97/11*) and these should apply regardless of the type of business being conducted. These indicators include:

- whether the activity has a significant commercial purpose or character
- whether the taxpayer has more than just an intention to engage in business
- whether the taxpayer has a purpose of profit as well as a prospect of profit from the activity
- whether there is regularity and repetition of the activity

- whether the activity is of the same kind, and carried on in a similar manner, to that of ordinary trade in that line of business
- whether the activity is planned, organised and carried on in a businesslike manner — this may be indicated by the size, scale and permanency of the activity, and
- whether the activity is better described as a hobby, a form of recreation or sporting activity.

No one indicator is decisive in determining whether a business exists (*Evans v FC of T 89 ATC 4540*). The indicators must be considered in combination and as a whole.

Although the fundamentals for determining when business activities are being carried on are the same for traditional businesses and online businesses, there are further characteristics to consider in Catherine's case.

Based on the nature of Catherine's work, she could be considered carrying on a business as a professional artist (*Taxation Ruling TR 2005/1*). A professional artist is a person who carries on the activities of a "professional arts business" (ITAA97 s 35-10(5)) as either:

- (a) an author of a literary, dramatic, musical or artistic work
- (b) a performing artist, or
- (c) a production associate.

TR 2005/1 states that the nature of art activity means that arts businesses typically have different characteristics to those found in other businesses. For example, people who engage in professional arts businesses are often motivated by creative purposes and the desire to influence public opinion. Art is not always produced with a pre-existing market in mind; rather, an innovative artist may have to create a new market for their work. For this reason, a large part of being in business as a professional artist may involve activities directed towards reputation building and audience/market creation. This would appear to be relevant when considering many online social media type revenue streams.

The usual indicators described above still apply to these artistic businesses. However, with the high risk associated with arts businesses, profit may not be an appropriate factor (*Taxation Ruling TR 2005/1*) and other indicators may need to be considered such as:

- repetition
- activities of the same kind, and
- size and scale.

At the outset, Catherine was only doing make-up as a hobby. Even with her YouTube success it would be reasonable to accept that her activities would still not be considered carrying on a business, as the activities were yet to be monetised.

When Catherine started receiving monthly payments from AdSense (AdSense has a payment threshold), this would be the point in time when she had the business indicators of repetition, size, scale, and business records. It would be

at the time that her activities moved from being a hobby and became a business. At this juncture, she would be required to include the money from her social media activities as assessable income in her tax return.

Once Catherine is carrying on a business, the earnings or proceeds of the business are to be included in her assessable income, and deductions are allowable for all expenses of a revenue nature incurred in the course of deriving that income.

If the online business is profitable, she must include the taxable income from the business in her tax return along with the salary and wages from her assistant job.

If Catherine is making a loss from her online business, she may not be able to offset the loss against the taxable income derived from her sales assistant job because the non-commercial business provisions in ITAA97 Div 35 may be triggered to quarantine her losses. There are certain thresholds that need to be satisfied to permit the losses to be applied.

AMTG: ¶2-135, ¶10-105, ¶16-020

## ¶1-060 Disaster and relief payments

### Issue

Jasper Onyx operates the Speedy cleaning and courier business in the Macleay Valley. In November 2024, a bushfire caused major damage in and around the region and Speedy was closed until April 2025.

Jasper had insured his business for any loss of profit that could be due to natural disasters. He claimed the premiums as allowable deductions each year and always paid the correct amount by the due date through Speedy. In providing substantiation, Jasper received \$200,000 on 23 June 2025 as a payment on the insurance policy for lost income relating to the forced closure.

A public fund was established to accept donations from people wishing to provide assistance to victims of the bushfire. The fund received donations from the public that were tax deductible and large contributions from the NSW and federal government. The charity made one-off payments of \$5,000 to individuals and \$50,000 to small businesses impacted by the bushfire. The payments were unconditional. Jasper received \$5,000 for himself and \$30,000 for Speedy in February 2025.

Are Jasper or Speedy required to declare any of these amounts as assessable income in either of their 2024–25 tax returns?

### Solution

#### Insurance payout

Insurance payments or other receipts in respect of lost trading stock by fire or destruction and amounts received for loss of profits or income due to an interruption to business caused by fire are assessable either as ordinary income (ITAA97 s 6-5) or statutory income (ITAA97 s 15-30).

¶1-060

As the insurance payment was received on 23 June 2025, Speedy should include the \$200,000 payment in the 2024–25 income year.

### Payments from the public fund

The receipt of money or other property by way of a simple gift and nothing more is not a receipt of income. A receipt of a voluntary payment of money or a voluntary transfer of property is prima facie not income in the hands of the recipient. Government payments received by a charity that form an unidentifiable part of the overall funds received for the purpose of providing aid to persons in need do not alter the non-taxable nature of the aid provided by the charity (*Taxation Determination TD 2006/22*).

On this basis, both Jasper individually and Speedy are not required to treat the amounts from the public fund as income. The amounts are considered tax free and therefore need not be declared as assessable income in either of their 2024–25 tax returns.

AMTG: ¶10-070, ¶10-170, ¶44-130

## ¶1-080 Illegal activities

### Issue

Natasha Romanov is the CFO of E Corp Pty Ltd (E Corp). During the 2022–23 income year she misappropriated \$360,000 worth of company funds.

In the 2024–25 income year, as a result of data matching, the ATO identified the amount that was misappropriated from E Corp. As a result of the audit, Natasha was indicted and convicted in December 2024. She was issued a court restitution order to repay \$300,000 to E Corp. She was also fined \$120,000.

In January 2025, Natasha needed additional funds to repay the money. She appeared on a current affairs television show to discuss her crime and was paid \$50,000.

What are the tax outcomes for Natasha in relation to the income and the expenses arising from her illegal activities?

### Solution

Income derived from illegal or *ultra vires* transactions conducted in a systematic, regular and organised way with a view to a profit can constitute business income. Accordingly, this income, although from illegal activities, is subject to the same tax provisions as any other business income. For example, the appropriation of cash by a managing director was considered assessable income in the hands of the managing director (*Case B32 70 ATC 153*). Therefore, Natasha is required to include the additional \$360,000 as taxable income for the 2022–23 income year and pay any shortfall interest amounts and penalties associated.

Losses or outgoings necessarily incurred in carrying on an illegal or *ultra vires* business may be deductible under ITAA97 s 8-1. However, amounts obtained from an illegal activity that are subsequently repaid or recovered, for whatever reason, will not be allowable deductions because such amounts are not incurred in any way for the purpose of obtaining the illegal proceeds.

Generally, repayment or restitution is imposed on the offender as a means of retribution and is not incurred by the offender in earning the proceeds. Such payments represent a repayment of income as opposed to an outlay incurred in deriving that income.

On this basis, Natasha is not permitted to deduct the restitution amount of \$300,000 in the 2024–25 income year. However, since the amount directly relates to assessable income of \$360,000 previously recognised in the 2023–24 income year, the \$300,000 is permitted to reduce the \$360,000 from the 2023–24 income year. Accordingly, additional assessable income for the 2023–24 income year is reduced to \$60,000 — any shortfall interest charge is also reduced.

Further, fines and penalties payable are specifically not allowable deductions (ITAA97 s 26-5). Accordingly, Natasha is not permitted to deduct the \$120,000 fine in the 2024–25 income year.

Natasha would also be required to include the \$50,000 from the television interview in her assessable income for the 2024–25 income year as the appearance was part of her “business activities” and there was a view to profit from the interview.

AMTG: ¶10-010, ¶10-450, ¶16-010, ¶16-105

## ¶1-100 Compensation for breach of business agreement

### Issue

Australian Oil Distributors (AOD) supplies petrol and oil products to a number of independent service stations (Independents). AOD receives petrol and oil products under an agreement with Mid-Eastern Oil (MEO) which AOD pays MEO \$1 million annually.

MEO advised AOD that it was terminating the agreement and would be entering into a supply agreement with a competitor of AOD. AOD sought compensation of \$2 million from MEO for the impact on its business arising from breach of the agreement.

The action against MEO was subsequently settled with MEO agreeing to pay AOD a lump sum of \$1.5 million on the condition that AOD would not enter into any contract or agreement with any other oil producer in order to acquire petrol and oil products for supply to independent service stations for 2 years. The payment included compensation for any damage to AOD’s reputation in the industry.

Advise AOD on the tax consequences of receiving the payment of \$1.5 million from MEO.

### Solution

In general, compensation takes on the character of what it replaces (C of (NSW) v Meeks (1915) 19 CLR 568 and *Heavy Minerals Pty Ltd v FC of T* (1986) 115 CLR 512). Amounts received in connection with the breach or cancellation

of commercial contracts may be of an income nature. In the case of agency contracts, if the cancellation is for one of a number of contracts compensation may be regarded as a normal trading risk and would be treated as ordinary income (*Allied Mills Industries Pty Ltd v FC of T* (1989) 20 FCR 288). However, where the agency agreement is the whole or greater part of the business earnings such that cancellation would damage or destroy the profit-making structure of the business, the compensation will be of a capital nature (*Californian Oil Products (in liq) v FC of T* (1934) 52 CLR 28, *Case Y24 91 ATC* 268).

The first issue is to determine whether the \$1.5 million received by AOD is of an income or capital nature and assessable as ordinary income under ITAA97 s 6-5 or assessable as a capital gain under ITAA97 s 104-25. If ITAA97 s 6-5 is held not to apply, it may be necessary to consider whether the compensation is assessable as an assessable recoupment under ITAA97 s 20-25.

It is also necessary to consider the substance of the \$1.5 million payment, that is, whether it comprises liquidated or unliquidated damages and if the sum can be dissected into income and/or capital components. Where the relevant payment can be dissected into income and capital components, the income components will be assessable income under ITAA97 s 6-5(1). Capital components may attract capital gains tax. If the payment cannot be dissected the entire amount is treated as capital and taxed as a capital gain (*McLaurin v FC of T* (1961) 104 CLR 381, *Allsop v FC of T* (1965) 113 CLR 341 and *FC of T v CSR Ltd* 2000 ATC 4710).

Finally, the impact of the restrictive covenant condition in the settlement needs to be considered as well as allowance for damage to AOD’s reputation in the industry.

If AOD argues that the \$1.5 million is unliquidated damages and cannot be dissected into income and capital components, the entire amount will be assessable income under the capital gains tax provisions. The CGT event would be the disposal of the asset, that is, of AOD’s right to sue for damages (*Taxation Ruling TR 95/35*).

However, if the \$1.5 million can be dissected into component elements, then:

- the amount attributable to loss of sales revenue will be treated as ordinary income and assessable under s 6-5
- any amount that is an indemnity or recoupment of a deductible expense, which is not otherwise assessable income under s 6-5, will be an assessable recoupment under ITAA97 s 20-20
- amounts attributable to damage to or sterilisation of AOD’s profit-making structure (*Van den Berghs Ltd v Clark* [1935] AC 431) or damage to business reputation will be treated as an assessable capital gain
- the amount received in relation to agreeing to the restrictive covenant will be a capital gain arising from CGT event D1 (ITAA97 s 104-35(1)), and

### CGT consequences in relation to AGL Ltd share transactions

The AGL Ltd shares are a pre-CGT asset. The 200 bonus shares are deemed to be acquired at the time of acquisition of the original shares (ITAA97 s 130-20(3)). The 2,200 shares maintain their status as pre-CGT assets. The disposal of 1,000 shares (apportioned between original and bonus shares) is exempt from CGT (ITAA97 Div 104). However, any gain on disposal of the shares may be assessable as an extraordinary transaction on the basis of *Emporium* 87 ATC 4363, or as a profit-making undertaking or plan (ITAA97 s 15-15).

### CGT consequences in relation to TEL share transactions

The TEL Ltd shares are a post-CGT asset. The 150 bonus shares are deemed to be acquired at the date of acquisition of the original shares, that is, 15 May 1987 (ITAA97 s 130-20(3)). The cost base of the shares is spread over both the original and bonus shares:

$$\frac{\$18,000}{3,000 + 150} = \$5.71$$

Since the shares were acquired before 21 September 1999, in calculating any capital gain David Jones has the option of indexing the cost base or applying the 50% capital gains discount and choosing the option yielding the lesser CGT liability.

### Capital gain when indexing the cost base

Element	Transaction	Amount
Capital proceeds	1,500 shares @ \$20	30,000
Cost base	1,500 shares @ \$5.71	8,565
Indexed cost base	\$8,565 × 1.493*	12,787.55
<b>CAPITAL GAIN</b>		<u>17,212.45</u>

$$\frac{\text{*September 1999}}{\text{June 1987}} = \frac{68.7}{46.0} = 1.493$$

### Capital gain applying the 50% capital gain discount

Element	Transaction	Amount
Capital proceeds		\$ 30,000
Cost base	1,500 shares @ \$20	8,565
Capital gain	1,500 shares @ \$5.71	21,435
Capital gain 50% discount		10,717.50
<b>NET CAPITAL GAIN</b>		<u>10,717.50</u>

David Jones should rely upon the 50% capital gain discount as it yields the lesser capital gain of \$10,717.50.

### CGT consequences in relation to IBM Ltd share transactions

The IBM Ltd shares are a post-CGT asset. The 1,000 bonus shares are deemed to be acquired at the date of acquisition of the original shares, that is, 20 August 1995. The cost base of the shares is spread over both the original and bonus shares, that is:

$$\frac{\$50,000}{5,000 + 1,000} = \$8.33$$

Since the shares were acquired before 21 September 1999, in calculating any capital gain David Jones has the option of indexing the cost base or applying the 50% capital gains discount and choosing the option yielding the lesser CGT liability. However, in the case of a capital loss, the cost base is not indexed.

### Capital gain or loss when indexing the cost base

Element	Transaction	Amount
Capital proceeds	2,000 shares @ \$5	10,000
Cost base	2,000 shares @ \$8.33	16,660
<b>(Capital loss)</b>		<u>6,660</u>

David Jones has experienced a capital loss of \$6,660 with the disposal of his IBM Ltd shares. Given this capital loss, the cost base is not indexed, and the 50% capital gain discount does not apply. As David Jones has made both a monetary and real capital loss, the capital loss can be offset against other capital gains or carried forward to offset against future capital gains.

### CGT consequences in relation to CSR Ltd share transactions

Since the bonus issue by CSR Ltd was paid out of profits, it constitutes a dividend. ITAA97 s 130-20(2) provides that the cost base of the bonus shares would include any part of the shares that are a dividend, and that the date of the acquisition would be the date the bonus shares were issued, that is, 1 April 2025. The cost base of the original shares would not be affected (ie it remains at \$2 per share, being \$12,000/6,000).

On a subsequent partial sale of shares (on 1 June 2025), if the first-in-first-out (FIFO) basis is adopted then 2,000 of the original shares would be taken to have been sold (*Taxation Determination TD 2000/2*).

## Capital gain or loss on disposal of original shares

Element	Transaction	Amount
Capital proceeds	2,000 shares @ \$1	\$ 2,000
Cost base (Capital loss)	2,000 shares @ \$2	4,000
		<u>2,000</u>

## CGT consequences in relation to WBC share transactions

The WBC Ltd shares were acquired on 14 December 2024 and disposed of on 1 June 2025. It is not permissible for David Jones to index the cost base in calculating any capital gain (ITAA97 s 114-1), nor is it permissible to apply the 50% capital gain discount because David Jones has not held the shares for more than 12 months (ITAA97 s 115-25).

The WBC Ltd shares are a post-CGT asset. The 1,000 bonus shares are deemed to be acquired at the date of acquisition of the original shares, that is, 14 December 2024. The cost base of the shares is spread over both the original and bonus shares, that is:

$$\frac{\$60,000}{4,000 + 1,000} = \$12.00$$

## Capital gain on the disposal of shares in WBC Ltd

Element	Transaction	Amount
Capital proceeds	1,000 shares @ \$20	\$ 20,000
Cost base	1,000 shares @ \$12	12,000
CAPITAL GAIN		<u>8,000</u>

The \$8,000 capital gain will be added to other capital gains derived by David Jones in the 2024–25 year.

## Summary

In working out his net capital gain for 2024–25, David Jones needs to follow the steps in ITAA97 s 102-5(1). This allows David Jones to deduct capital losses from relevant capital gains before applying the 50% capital gains discount. The steps are as follows:

Capital gain on disposal of WBC Ltd (neither indexing nor discounting)	\$ 8,000
Less capital loss on disposal of IBM Ltd shares	(6,660)
Less capital loss on disposal of CSR Ltd shares	(2,000)
Net capital loss	<u>(660)</u>

Add capital gain on disposal of TEL Ltd shares	\$ 21,435
Net capital gain	20,775
Application of 50% discount	10,387.50
Total capital gain for 2024–25	<u>10,387.50</u>

AMTG: ¶11-000, ¶11-030, ¶11-036, ¶11-240, ¶11-250, ¶11-380, ¶11-500, ¶11-550, ¶11-610, ¶12-600

## ¶2-260 Share options

## Issue

In February 1980, Annette Monroe acquired 1,000 shares in Targette Pty Ltd from Anthony Neal for \$5 per share. On 1 March 2024, Anthony offered Annette the right or option to acquire one share for each 5 shares held. The cost of the right or option was \$1 per share. Annette exercised the option on 11 November 2024 and acquired 200 shares at \$15 each. At the end of January 2025, Annette disposed of her entire shareholding in Targette Pty Ltd for \$18 per share.

Advise both Annette Monroe and Anthony Neal on the CGT consequences of the share option transactions.

## Solution

CGT event D2 happens if a taxpayer grants an option to an entity, even if the grantor of the option does not own the property at the time of grant. The time of CGT event D2 is when the option is granted (ITAA97 s 104-40). The capital gain is the capital proceeds from granting the option less the cost base, consisting of expenditure incurred in the grant of the option. A capital gain from CGT event D2 cannot be a discount capital gain (ITAA97 s 115-25(3)).

In the case of rights or options to acquire shares, the rights or options are taken to be acquired at the time of acquisition of the original shares. However, if the original shares are a pre-CGT asset and the rights or options are granted on or after 20 September 1985, the rights or options are a post-CGT asset.

When an option is exercised any capital gain or loss resulting from CGT event D2 is disregarded (ITAA97 s 104-40(5)). Instead, the amount paid for or received for the grant of the option is added to the capital proceeds and cost base on the disposal of the underlying property. The cost base and reduced cost base of the option are modified under ITAA97 s 134-1.

## CGT consequences for Annette Monroe

The original 1,000 shares are pre-CGT assets and do not attract CGT on disposal. The 200 shares acquired in November 2024 are post-CGT assets and attract CGT. The cost base for the 200 shares comprises the cost of the rights or options at \$1 per share and the price paid for acquisition of the shares, namely \$15 per share.

# Chapter 6

## DEPRECIATION

- Decline in value and other deductions ..... ¶6-000
- Apportioning deduction for decline in value of depreciating assets ..... ¶6-020
- Deduction for capital works ..... ¶6-120
- Decline in value deductions and balancing adjustment on disposal ..... ¶6-140
- Balancing adjustments; disposal of depreciating assets ..... ¶6-160
- Balancing adjustments; disposal of business and non-business assets; capital gains ..... ¶6-180
- Disposal of depreciable asset used for private purposes ..... ¶6-200
- Purchase of intangible business assets; calculating decline in value ..... ¶6-220
- Depreciating assets; intangible assets; plant ..... ¶6-240
- Commercial website development expenditure ..... ¶6-260
- Pooling low cost and low value depreciating assets ..... ¶6-280
- Small business entity assets; general small business pool ..... ¶6-300
- Small business entity assets; temporary changes to immediate deduction ..... ¶6-320
- Primary producers; accelerated depreciation rates ..... ¶6-360
- Second-hand depreciating assets in residential premises ..... ¶6-380
- Composite items — identifying the relevant depreciating asset for capital allowances purposes ..... ¶6-400
- Lease incentive payments: Free fit-outs ..... ¶6-420

Depreciation

## ¶6-000 Decline in value and other deductions

### Issue

Angela Codak runs a studio photography business. On 1 September 2024 Angela decided to extend her business and purchased audio-visual equipment. The equipment cost \$12,000 plus \$400 for installation and \$1,800 for a one-year contract for 2 hours' training each month for the first 6 months. Angela was advised that the equipment had an effective life of 4 years. She also commissioned the development of film editing software for \$3,500.

Advise Angela on tax deductions available in relation to the purchase and use of the audio-visual equipment.

Angela has opted out of the simplified depreciation regime for small business.

### Solution

The audio-visual equipment is a capital expense and not deductible under ITAA97 s 8-1 (see also *British Insulated & Helsby Cables v Atherton* [1926] AC 205; and *Sun Newspapers Ltd v FC of T* (1938) 61 CLR 337). In *British Insulated & Helsby Cables*, Viscount Cave formulated the test for characterising a capital outgoing:

"When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or advantage for the enduring benefit of a trade ... there is very good reason ... for treating such expenditure as properly attributable not to revenue but to capital."

In *Sun Newspapers*, Dixon J formulated the business entity test:

"The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between [on the one hand] the business entity, structure, or organisation set up or established for the earning of profit and [on the other hand] the process by which such an organisation operates to obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss ..."

However, the audio-visual equipment is a depreciating asset (ITAA97 s 40-30) and a capital allowance deduction is available to Angela.

The first element of cost is the \$12,000 purchase price (ITAA97 s 40-180) and the second element is \$400, ie the amount incurred in having the equipment installed ready for use (ITAA97 s 40-190). The capital allowance deduction will be based on the cost figure of \$12,400.

The costs towards developing the film editing software may be allocated to a software development pool (ITAA97 s 40-450) and depreciated over 5 years. The deduction in year one is nil and 30% in years two, three and four and the remaining 10% in year five. Angela will not be entitled to a capital allowances deduction for the software in 2024-25 (ITAA97 s 40-455).

The expense of \$1,800 incurred in entering into the training contract is a revenue expense rather than a capital one and is deductible under ITAA97 s 8-1.

Calculation of depreciation of the audio-visual equipment:

Depreciable cost	\$12,400
Apportionment	1 September 2024 to 30 June 2025 = 304 days / 365 days
Effective life	Four years

Diminishing value method for calculating the decline in value (ITAA97 s 40-72):

$$\frac{\text{Base value}}{\text{Asset's effective life}} \times \frac{\text{Days held}}{365} \times 200\%$$

Applied to Angela:

$$\frac{\$12,400}{4 \text{ years}} \times \frac{304}{365} \times 200\% = \$5,164$$

Angela has the choice of using the prime cost method for calculating the decline in value. However, the deduction for 2024-25 would only amount to \$2,582, calculated using the following formula (ITAA97 s 40-75):

$$\text{Prime cost deduction} = \frac{\text{Cost}}{\text{Effective life}} \times \frac{\text{Days held}}{365}$$

$$\text{Prime cost deduction} = \frac{\$12,400}{4 \text{ years}} \times \frac{304}{365} = \$2,582$$

Angela is advised to apply the diminishing value method over the prime cost method as it results in a greater capital allowance deduction for 2024-25. Once this method is chosen for the particular asset, it applies to that asset in later income years.

## ¶6-020 Apportioning deduction for decline in value of depreciating assets

### Issue

Doug Johnson resigned from his employment as a bus driver and established a learner driver training school. On 1 July 2024, Doug purchased a Toyota Camry sedan for \$37,000 incurring dealer delivery charges of \$2,000 and registration and insurance costs amounting to \$4,000. Doug had the vehicle modified by installing dual controls, at a cost of \$2,500. During the year the vehicle was used for both private and driver learner training purposes. As at 30 June 2025, the log book registered 48,000 km as the total distance travelled of which 30,000 km were for learner driver training. Doug estimates the vehicle has an effective life of 240,000 km.

On 1 March 2025, Doug added another vehicle to his driver training school. This second car, a Mazda 2, cost \$25,000 with dealer delivery charges of \$1,800

and registration and insurance amounting to \$3,600. The vehicle was modified with the installation of dual controls at a cost of \$2,400. The vehicle was used entirely for learner driver training purposes and travelled 6,000 km up to 30 June 2025. Doug estimated the vehicle has an effective life of 90,000 km.

Advise Doug Johnson on the tax deductions available to him in relation to his learner driver training business.

### Solution

A deduction is available for losses or outgoings incurred in gaining or producing assessable income or carrying on a business for the purpose of gaining or producing assessable income (ITAA97 s 8-1(1)). However, a taxpayer cannot deduct a loss or outgoing under s 8-1(1) to the extent that it is a loss or outgoing of capital, or of a capital nature (s 8-1(2)(a)).

A capital allowance is available for depreciating assets, provided the taxpayer is the holder of the asset (ITAA97 s 40-1). A depreciating asset has a limited effective life (ITAA97 s 40-30). The taxpayer can deduct the decline in value of the depreciating asset held during an income year (ITAA97 s 40-25(1)). The deduction is reduced if the asset is only partly used for a taxable purpose (s 40-25(2) and 40-25(7)). The deduction is also apportioned if the asset is used for only part of the year.

The process for calculating the deduction involves determining the cost of the depreciating asset and its effective life, then choosing either the prime cost or diminishing value method for calculating the annual deduction. The closing value at the end of the year is the opening value for calculating the deduction in the next year.

### Capital allowance in relation to the Toyota Camry

As the legal owner of the vehicle, Doug is entitled to claim the depreciation deduction. The cost of the vehicle has 2 elements. The first is the purchase price of \$37,000 (ITAA97 s 40-180). The second element includes costs incurred in bringing the asset to its present condition (ITAA97 s 40-190). For Doug, this would include the dealer delivery charge of \$2,000 as well as the dual controls modification costing \$2,500.

The registration and insurance would not be included in the cost but would be deductible under s 8-1(1) to the extent the car was used for income producing purposes (that is, 62.5% for the Camry and 100% for the Mazda 2).

Doug can estimate the effective life of the vehicle or rely on the Commissioner's determination (ITAA97 s 40-95). Doug estimates that the vehicle has an effective life of 240,000 km which at 48,000 km per year translates into an effective life of 5 years. Doug then has the choice of using the prime cost method (ITAA97 s 40-75) or the diminishing value method (ITAA97 s 40-72) for calculating the annual depreciation deduction.

### Calculation of depreciation deduction:

Cost element 1: cost of Toyota Camry	\$37,000
Cost element 2: cost of bringing vehicle to its present condition	4,500
Total cost	<u>\$41,500</u>

Apportionment for business purposes: 30,000 km / 48,000 km = 0.625

### Diminishing value method (s 40-72):

$$\frac{\text{Base value}}{\text{Asset's effective life}} \times \frac{\text{Days held}}{365} \times 200\% \times \text{Business purposes}$$

$$\frac{\$41,500}{5 \text{ years}} \times \frac{365}{365} \times 200\% \times 0.625$$

Capital allowance deduction for Toyota Camry for 2024–25 = \$10,375

### Prime cost method (s 40-75):

$$\frac{\text{Cost}}{\text{Effective life}} \times \frac{\text{Days held}}{365} \times \text{Business purposes}$$

$$\frac{\$41,500}{5 \text{ years}} \times \frac{365}{365} \times 0.625 = \$5,187.50$$

The diminishing value method is preferred, yielding a deduction of \$10,375 compared to the prime cost method which yields a deduction of only \$5,187.50.

### Capital allowance in relation to the Mazda 2

The cost element 1 for the Mazda 2 is \$25,000. Cost element 2 is \$4,200 making the total cost for capital allowance purposes \$29,200. Doug estimated the effective life is 90,000 km. The vehicle travels 6,000 km in 4 months which equates to 18,000 km per year. This translates into an effective life of 5 years.

### Calculation of depreciation deduction

Cost element 1: cost of Mazda 2	\$25,000
Cost element 2: cost of bringing vehicle to its present condition	4,200
Total cost	<u>\$29,200</u>

Apportionment: days vehicle held in 2024–25 (1 March to 30 June 2025) = 122 days

Diminishing value method (s 40-72):

$$\frac{\text{Base value}}{\text{Asset's effective life}} \times \frac{\text{Days held}}{365} \times 200\%$$

$$\frac{\$29,200}{5 \text{ years}} \times \frac{122}{365} \times 200\%$$

Capital allowance deduction for Mazda 2 for 2024–25 = \$3,904.

The prime cost method results in a capital allowance deduction for the Mazda 2 for 2024–25 of \$1,952 (\$29,200 / 5 years × 122 / 365 days).

Doug is advised to apply the diminishing value method over the prime cost method as it results in a greater capital allowance deduction for 2024–25.

## ¶6-120 Deduction for capital works

### Issue

Clive Randle is a property developer and, in 2000, he decided to diversify his activities by constructing hotels, residential apartment blocks and factory units for industrial activities. During 2000–01, the following contracts were entered into:

#### Hotel

Contract date: 1 October 2000

Construction commenced: 1 February 2001

Construction completed and hotel operating: 1 March 2002

Construction cost: \$1.5 million

#### Residential apartment block

Contract date: 1 December 2000

Construction commenced: 1 April 2001

Construction completed and all apartments occupied: 1 January 2002

Construction cost: \$2 million

#### Factory units

Contract date: 1 May 2001

Construction commenced: 1 July 2001

Construction completed and factory units leased for industrial activities: 1 January 2002

Construction cost: \$1 million

On 15 April 2025, Clive accepted an offer on the apartment block and sold it to an investor for \$3.5 million.

Advise Clive on the tax deductions available to him in relation to his hotel, apartment block and factory units for the 2024–25 year.

### Solution

Tax deductions are available for depreciating assets (ITAA97 s 40-25, 40-30). The deduction does not apply to capital works for which a deduction is available under ITAA97 Div 43 (ITAA97 s 43-10).

A deduction is available for capital works, which include buildings begun in Australia after 21 August 1979. The rate of deduction is either 2.5% or 4%, depending on the type of capital works and the date on which construction commenced (ITAA97 s 43-25). However, the deduction cannot be claimed until construction is complete and the building is used for income-producing purposes (ITAA97 s 43-30).

The rate of deduction for capital works is contained in ITAA97 s 43-25.

For capital works begun after 26 February 1992:

- there is a basic entitlement to a rate of 2.5% for uses described in the Table in ITAA97 s 43-140 (current year use)
- the rate increases to 4% for uses described in the Table in ITAA97 s 43-145.

For capital works begun before 27 February 1992 and used as described in the Table in ITAA97 s 43-140, the rate is:

- 4% for capital works begun after 21 August 1984 and before 16 September 1987, or
- 2.5% in any other case.

The deduction is calculated according to the steps in:

- ITAA97 s 43-210 for capital works begun after 26 February 1992, or
- ITAA97 s 43-215 for capital works begun before 27 February 1992.

A balancing adjustment is taken into account on the disposal of a depreciating asset (ITAA97 s 40-285). However, there is no balancing adjustment on the disposal of capital works. Rather, the undeducted construction expenditure over the remaining life of the capital works carries over to the new owner of the capital works. For post-26 February 1992 undeducted construction expenditure, the calculation is according to the steps in ITAA97 s 43-235.

The period over which deductions can be claimed for capital works is 40 years, where the rate of deduction is 2.5%, and 25 years for those works for which the rate is 4%. It is not permissible to recover more than 100% of the capital expenditure of the capital works (ITAA97 s 43-15).

### Capital works deduction for hotel for 2024–25

Construction of the hotel commenced on 1 February 2001. Construction was completed and the hotel started operation on 1 March 2002. The deduction rate is 4% and is available for the entire 2024–25 year.

### Calculation of the hotel capital works deduction

$$\$1,500,000 \times 365 / 365 \times 4\% = \$60,000$$

### Capital works deduction for apartment block for 2024–25

Construction of the apartment block commenced on 1 April 2001. Construction was completed and all of the apartments were occupied on 1 January 2002. The deduction rate is 2.5%. However, the apartment block was disposed of on 15 April 2025.

The capital works deductions claimed by Clive Randle up to the date of disposal are calculated as follows:

Deduction for the period 1 January 2002–30 June 2002  
 $\$2,000,000 \times 181 / 365 \times 2.5\% = \$24,795$

Deduction for the 6 leap years (2004, 2008, 2012, 2016, 2020, 2024)  
 $\$2,000,000 \times 366 / 365 \times 2.5\% \times 6 = \$300,822$

Deduction for 16 non-leap years  
 $\$2,000,000 \times 365 / 365 \times 2.5\% \times 16 = \$800,000$

Deduction for the period 1 July 2024–15 April 2025  
 $\$2,000,000 \times 288 / 365 \times 2.5\% = \$39,452$

Total capital works deduction for Clive's apartment block over the period of ownership = \$1,165,069.

Undeducted construction expenditure that may be claimed by the investor purchasing the apartment block:  $\$2,000,000 - \$1,165,069 = \$834,931$ .

Given that Clive received \$3.5 million for the sale of the apartment block, CGT issues will also apply.

### Capital works deduction for factory units for 2024–25

Construction of the factory units commenced on 1 July 2001. Construction was completed and all units were leased for industrial activities and in operation on 1 January 2002. The deduction rate is 4% (ITAA97 s 43-145) and is available for the entire 2024–25 year.

#### Calculation of the factory units' capital works deduction

$$\$1,000,000 \times 365 / 365 \times 4\% = \$40,000$$

AMTG: ¶17-015, ¶17-030, ¶20-470, ¶20-480, ¶20-490, ¶20-500, ¶20-520, ¶20-530

## ¶6-140 Decline in value deductions and balancing adjustment on disposal

### Issue

Jackie Anderson is a qualified hire car driver and, on 1 November 2021, she purchased a new BMW for \$80,000, which was to be used in her hire car business as well as for private purposes. Jackie's logbooks indicate that 80% of

the kilometres travelled in a year relate to her hire car business. Jackie estimates that the effective life of the BMW will be 10 years, with a total of 20,000 km driven each year.

On 1 March 2025, Jackie traded-in her BMW for a Jaguar. The trade-in on the BMW was \$43,212 and the cost of the Jaguar was \$51,000. Jackie estimated that the hire car business usage would be 45,000 km each year. With the increased usage, she estimates that the effective life of the Jaguar will be 4 years.

Before the introduction of Temporary Full Expensing (TFE), Jackie depreciated her vehicles using the diminishing value method and chose to self-assess the effective life of her vehicles. Advise Jackie on the depreciation deductions she would be entitled to for her hire car business or additions to her assessable income in the 2024–25 tax year.

Jackie was not an SBE and did not choose to opt out of TFE.

### Solution

Tax deductions are available for losses or outgoings incurred in gaining assessable income or carrying on a business for the purpose of gaining assessable income (ITAA97 s 8-1(1)), unless the loss or outgoing is of capital or a capital nature (s 8-1(2)(a)). However, a deduction is available for depreciating assets (ITAA97 s 40-25) under the capital allowances regime and, in relation to assets acquired after 7.30 pm on 6 October 2020, TFE (ITPA97 Subdiv 40-BB). Jackie's motor vehicles qualify as depreciating assets.

The cost (ITAA97 s 40-180) of the asset is the starting point in calculating depreciation and TFE. However, there is a cost limit for cars (ITAA97 s 40-230), currently \$69,674, for 2024–25 (per the ATO website). (Note: Annual Taxation Determinations for the car limit are no longer published.)

In relation to eligible new assets first held, first used or installed ready for use for a taxable purpose from 7.30 pm AEDT on 6 October 2020 to 30 June 2023, temporary full expensing is available (see Subdiv 40-BB *Income Tax (Transitional Provisions) Act 1997*). Under TFE, the whole cost of the car could be depreciated up to the expensive car limit then in force (\$60,733 for 2021–22). A balancing adjustment arises where the car is subsequently sold.

An additional adjustment is required where, as in Jackie's case, the asset is used for both income-producing and private purposes (ITAA97 s 40-25(2)). The extent to which the asset is used for private purposes will impact on the calculation of TFE and the amount of any balancing adjustment on disposal of the asset.

When a depreciating asset is disposed of, such as Jackie's disposal of her BMW, a balancing adjustment is required (ITAA97 s 40-295), where there is a difference between the termination value (ITAA97 s 40-300) and the adjustable value at the time of disposal (ITAA97 s 40-85). If the termination value is more than the adjustable value, the excess is assessable (ITAA97 s 40-285(1)) whereas, if the termination value is less than the adjustable value, the difference is deductible (s 40-285(2)). Under TFE, the adjustable value is always nil (as the whole cost of the car is written off on acquisition).

If a balancing adjustment event happens for a car subject to the car limit, the termination value is adjusted for the purpose of calculating any balancing adjustment.

A further complication arises in Jackie's case because her BMW was used for both business and private use. The balancing adjustment amount is reduced to the extent that the vehicle is used for private purposes, according to the formula in ITAA97 s 40-290.

**Depreciation of the BMW**

Cost of BMW on 1 November 2021	\$ 80,000
Car depreciation limit in 2021-22 (per ATO website)	60,733
Less decline in value under TFE:	60,733

Adjustable value on 1 March 2025	0
Adjusted termination value (trade-in) on 1 March 2025	32,805

Recognising that the cost of the car exceeded the car limit, the termination value for the purpose of calculating any balancing adjustment is adjusted (ITAA97 s 40-325) as follows:

$$\text{sale price} \times \frac{\text{car limit}}{\text{actual cost of vehicle}}$$

ie \$43,212 ×  $\frac{\$60,733}{\$80,000}$

adjusted sale price (termination value) = \$32,805

As the termination value (\$32,805) is more than the adjustable value of the car (\$nil), Jackie will suffer a balancing charge of \$32,805 for 2024-25. However, an adjustment needs to be made to take account of non-business use, by applying the formula:

$$\text{Balancing deduction amount} \times \frac{\text{Sum of reductions}}{\text{Total decline}}$$

**Balancing adjustment on disposal of the BMW in 2024-25**

Total depreciation attributable to personal use = \$60,733 × 0.2 = \$12,147

Reduction for personal use =

$$\text{Balancing charge amount} \times \frac{\text{Sum of reductions}}{\text{Total decline}}$$

$$\$32,805 \times \frac{\$12,147}{\$60,733} = \$6,561$$

For 2024-25, the balancing charge added to Jackie's assessable income, on the disposal of the BMW is reduced by \$6,561 from \$32,805 to \$26,244 to take into account the 20% private use of her BMW.

**Depreciation of the Jaguar in 2024-25**

Purchase price of Jaguar on 1 March 2025 = \$51,000

Hire car business use: 45,000 km per year  
Effective life: 4 years

$$\text{Less decline in value: } \frac{\$51,000}{4 \text{ years}} \times \frac{122 \text{ days}}{365 \text{ days}} \times 200\% = \$8,523$$

Using the same log book and making an estimate of the business kilometres travelled, the apportionment of decline in value to take into account the 20% non-business use is:

$$\$8,523 \times 80\% = \$6,818$$

Opening adjustable value on 1 July 2025 = \$42,477

**Summary of depreciation deductions or additions to assessable income for Jackie in 2024-25**

Balancing charge, from disposal of the BMW, added to assessable income	(\$26,244)
Depreciation deduction for the Jaguar from 1 March 2025	\$6,818
AMTG: ¶17-080, ¶17-200, ¶17-270, ¶17-485, ¶17-500, ¶17-560, ¶17-570, ¶17-630, ¶17-640, ¶17-660	

**¶6-160 Balancing adjustments; disposal of depreciating assets**

**Issue**

Rene Richards owns and manages a business, trading as Alpine Printing. This business prints and publishes lifestyle, real estate and financial magazines and journals. He does not apply the simplified depreciation rules.

Alpine Printing had acquired printing presses 1 to 3 before 12 March 2020. During the 2024-25 year, the following transactions took place relating to the business's printing presses.

<b>Printing press 1:</b>	
Opening value 1 July 2024:	\$150,000
Effective life:	10 years
Depreciated using diminishing value method	
Sold on 1 November 2024, for:	\$65,000

Printing press 2:  
 Opening value 1 July 2024: \$100,000  
 Effective life: 10 years  
 Depreciated using diminishing value method  
 Sold on 1 February 2025, for: \$125,000

Printing press 3:  
 Opening value 1 July 2024: \$100,000  
 Effective life: 10 years  
 Depreciated using diminishing value method  
 Destroyed by fire on 1 April 2025  
 Insurance pay-out: \$132,000

Printing press 4:  
 Replacement printing press:  
 Purchased on 1 May 2025, for: \$180,000  
 Effective life: 10 years

Rene would like to know what deductions are available in relation to the capital transactions concerning his printing presses during 2024–25.

### Solution

The printing presses qualify as depreciating assets (ITAA97 s 40-30) and the owner, Rene, is entitled to claim deductions for the decline in value of the printing presses used during 2024–25 (ITAA97 s 40-25). For all assets acquired and installed and ready for use between 7.30 pm on 6 October 2020 and 30 June 2023, he can claim an immediate deduction under the TFE rules (ITPA97 Subdiv 40-BB). He is free to estimate the effective life of the printing presses (ITAA97 s 40-105) and apply the diminishing value method in calculating the decline in value over the year (ITAA97 s 40-65(1)) for assets acquired before and after those dates.

When depreciating assets are disposed of, a balancing adjustment must be calculated. If the termination value of a depreciating asset on disposal is less than its adjustable value, the difference is deductible in the year of the disposal (ITAA97 s 40-285(2)). If the termination value is more than the adjustable value on disposal, the excess is assessable in the year of the disposal (s 40-285(1)). The termination value is usually the selling price or amount received on disposal of the asset (ITAA97 ss 40-300 and 40-305) — this can be an insurance payout from the destruction of the asset. The adjustable value of a depreciating asset is initially its cost plus any second element costs incurred after the first year (the first year's second element costs being included in the cost of the asset), and subsequently its opening value at the commencement of the year, having deducted depreciation over the previous year (ITAA97 s 40-85).

Balancing adjustments may be subject to balancing adjustment relief and offset against the cost of a replacement asset. Conditions must be met to make this choice (ITAA97 s 40-365).

A gain on the disposal of a depreciating asset would normally give rise to a capital gain. However, this gain is specifically disregarded under ITAA97 s 118-24. Note that CGT event K7 applies to capture gains relating to the non-business use of depreciating assets.

### Printing press 1 balancing adjustment

#### Diminishing value method (ITAA97 s 40-72):

$$\frac{\text{Opening adjustable value}}{\text{Asset's effective life}} \times \frac{\text{Days held}}{365} \times 200\%$$

$$\frac{\$150,000}{10 \text{ years}} \times \frac{124}{365} \times 200\% = \$10,192$$

Adjustable value on 1 November 2024: \$150,000 – \$10,192 = \$139,808

Since the adjustable value at the time of disposal of \$139,808 is greater than the termination value of \$65,000, the difference of \$74,808 is deductible for Alpine Printing in the 2024–25 year.

### Printing press 2 balancing adjustment

#### Diminishing value method (s 40-72):

$$\frac{\text{Opening adjustable value}}{\text{Asset's effective life}} \times \frac{\text{Days held}}{365} \times 200\%$$

$$\frac{\$100,000}{10 \text{ years}} \times \frac{216}{365} \times 200\% = \$11,836$$

Adjustable value on 1 February 2025: \$100,000 – \$11,836 = \$88,164

Since the adjustable value at the time of disposal of \$88,164 is less than the termination value of \$125,000, the difference of \$36,836 is assessable income for Alpine Printing in the 2024–25 year.

### Printing press 3 balancing adjustment

#### Diminishing value method (s 40-72):

$$\frac{\text{Opening adjustable value}}{\text{Asset's effective life}} \times \frac{\text{Days held}}{365} \times 200\%$$

$$\frac{\$100,000}{10 \text{ years}} \times \frac{276}{365} \times 200\% = \$15,123$$

Adjustable value on 1 April 2025: \$100,000 – \$15,123 = \$84,877

Since the adjustable value at the time of destruction of the printing press of \$84,877 is less than the termination value of \$132,000, the difference of \$47,123 is assessable income for Alpine Printing in the 2024–25 year.

However, from the tenant's perspective, the result is less attractive. The tenant will be considered to have derived an assessable amount equal to the full cash incentive, meaning that the \$110,000 received is fully taxable upfront.

The costs associated with the fit-out will at best be treated as money expended on the acquisition of plant (in which case, that portion of the cost can be depreciated over the effective life of the plant — Div 40 ITAA97) and, at worst, as a capital works deduction, depreciated over 40 years (equal to a write-off of only 2.5% per year, under Div 43).

Therefore, Noreast is obliged to write off the \$120,000 over 40 years on a straight-line basis. This means that Noreast can only claim a deduction of up to \$3,000 each year, meaning that there is a large mismatch between the receipt of income (fully taxable) and the incurring of expenses (deductible over 40 years).

If the capital works are destroyed at the end of the lease, a balancing deduction may be available in the income year in which the destruction occurs. If the capital works are not destroyed (for example, if the business simply moves out, leaving the capital works in situ), no balancing adjustment is available. If the agreement stipulates that the landlord is required to buy the leasehold improvements, the landlord therefore takes over the capital works deductions for the balance of the write-off period.

Therefore, assuming the amounts spent are indeed capital works deductions, this produces an addition to taxable income for Noreast in the year of receipt of \$110,000 – \$3,000 = \$107,000, and a tax liability of \$107,000 @ 25% = \$26,750.

#### Landlord owns fit-out

A second option for fit-out incentives is that the landlord owns the fit-out up to the amount of the contribution.

In this case, the tenant does not receive "income" and cannot claim a deduction (except for the excess over the amount contributed, in this case \$10,000, which can be written off under Div 43, at 2.5% per year). Therefore, where the amount contributed equals the amount spent, the position for the tenant is broadly tax neutral.

However, the landlord does not get an immediate tax deduction and instead, assuming the entire amount has been spent on items which qualify for capital works deductions, gets to claim a deduction of 2.5% per year.

For this reason, this is far less common than the payment of a simple cash incentive.

AMTG: ¶10-116, ¶17-015

## Chapter 7 INDIVIDUALS

Resident individual; calculating tax liability .....	¶7-010
Taxable income; tax payable .....	¶7-020
PAYG instalments; tax offsets .....	¶7-040
Taxable income; tax offsets .....	¶7-060
Small business income tax offset; trust distributions .....	¶7-080
Primary producers; non-commercial losses .....	¶7-100
Tax concessions; personal superannuation contributions .....	¶7-120
Salary packaging; tax effectiveness .....	¶7-140
Salary packaging; company car .....	¶7-160
Salary sacrifice and superannuation guarantee charge .....	¶7-170
Income averaging scheme applied to sports person .....	¶7-180
Personal services income .....	¶7-200
Termination payments .....	¶7-220
Superannuation funds .....	¶7-240
Superannuation death benefit paid to family members .....	¶7-260
Downsizer contributions .....	¶7-265
First Home Super Saver Scheme .....	¶7-270
Catch-up concessional superannuation contributions .....	¶7-275
Total superannuation balance and the bring forward of non-concessional contributions .....	¶7-278
Employee v contractor: Extended definition of employee for superannuation guarantee purposes .....	¶7-279
CGT small business retirement exemption .....	¶7-280
Foreign salary; wages income .....	¶7-300
Exempt foreign income .....	¶7-320
Foreign income tax offset amendment period .....	¶7-340
Temporary residents; taxation of income .....	¶7-360
Working holiday makers .....	¶7-380
Residency, foreign residency and working holiday makers .....	¶7-390
Taxation of minors .....	¶7-400
Recovery of HELP debts .....	¶7-420
Sharing economy; ride-sourcing service; Uber drivers .....	¶7-440
Medicare levy surcharge; foreign health insurance policy .....	¶7-460
Medicare levy exemption for lump sum payments .....	¶7-480
Tax incentives for early stage investors .....	¶7-500

### ¶7-010 Resident individual; calculating tax liability

Lina Chua arrived in Australia on 1 June 2024 to take up a position with a bank and was a resident for tax purposes from that time. Before coming to Australia, Lina was a full-time student in Singapore. She was single and took out private health insurance when she arrived in Australia.

During 2024–25, Lina earned the following amounts:

- \$120,000 salary — \$38,000 tax was withheld by her employer during the year and remitted to the ATO
- fully franked dividends of \$11,000 with franking credits of \$4,714
- unfranked dividends of \$800
- rent of \$18,000 from an investment property
- interest of \$750, and
- a net capital gain on sale of investments of \$170.

Lina's expenditure during 2024–25 is:

- self-education expenses \$3,800
- gifts to deductible gift recipients \$6,500
- investment property repairs \$700
- bank fees \$120
- brokerage fees on the sale of investments \$600, and
- work expenses \$300.

Calculate Lina's tax liability for 2024–25.

#### Solution

An individual's tax liability for a financial year is calculated according to the following formula in ITAA97 s 4-10(3):

$$\text{Income tax} = (\text{taxable income} \times \text{rate}) - \text{tax offsets.}$$

The amount of income tax payable is calculated by following 5 steps:

- (1) Calculate the individual's taxable income for the income year.
- (2) Calculate the gross tax payable on the taxable income according to the applicable tax rates.
- (3) Calculate the individual's tax offsets for the income year.
- (4) Subtract the tax offsets from the gross tax payable — the result is the amount of net tax payable for the financial year.
- (5) Levies, charges and surcharges may need to be added.

#### Step 1

Lina's taxable income is calculated according to the formula in ITAA97 s 4-15(1) as:

$$\text{Taxable income} = \text{assessable income} - \text{deductions}$$

Lina's assessable income is \$155,434 (\$120,000 + \$11,000 + \$4,714 + \$800 + \$18,000 + \$750 + \$170).

Franking credits on dividends from Australian companies are assessable per ITAA36 s 44(1).

Lina's employer made \$13,800 superannuation guarantee contributions for her during the year (\$120,000 × 11.5%). These are not taken into account in calculating her assessable income.

Lina has allowable deductions of \$11,420 (\$3,800 + \$6,500 + \$700 + \$120 + \$300).

The self-education expenses of \$3,800 are fully deductible. The \$250 exclusion for prescribed courses of education (former ITAA36 s 82A) was abolished from 1 July 2022.

As the gifts were made to deductible gift recipients, the amount is deductible under ITAA97 s 30-45.

Brokerage fees on the sale of investments would form part of the second element of the cost base of the investment under ITAA97 s 110-35. They would be counted in the calculation of the net capital gain included in assessable income.

Lina's taxable income is \$144,014 (\$155,434 assessable income - \$11,420 allowable deductions).

#### Step 2

Lina's gross tax payable on taxable income of \$144,014, using the 2024–25 tax rates for a resident individual, is \$34,623.18, calculated as follows:

	\$
Tax on \$18,200	0
Plus (\$45,000 - \$18,200) × 16%	4,288.00
Plus (\$135,000 - \$45,000) × 30%	27,000.00
Plus (\$144,014 - \$135,000) × 37%	<u>3,335.18</u>

#### Step 3

Lina is entitled to a tax offset for the \$4,714 franking credits.

#### Step 4

Lina's gross tax payable is reduced to \$29,909.18 when the tax offset is subtracted.

#### Step 5

Lina is liable to Medicare levy of \$2,880.28 (\$144,014 taxable income × 2%). She is not liable to Medicare levy surcharge because she has private health insurance.

**Payment of income tax**

Lina's net tax payable is \$32,789.46 (\$29,909.18 gross tax payable + \$2,880.28 Medicare levy).

When she lodges her income tax return for 2024-25, credit is given for the \$38,000 tax withheld by her employer from her salary during the year. As the tax withheld exceeds her tax liability, she is entitled to a \$5,210.54 refund (\$38,000 - \$32,789.46).

AMTG: ¶2-090, ¶11-550, ¶16-460, ¶16-950, ¶42-000, ¶42-010

**¶7-020 Taxable income; tax payable**

**Issue**

The expenditure and receipts for Ted Jones for 2024-25 comprise the following:

<b>Receipts</b>	\$
Salary	92,000
Car expenses reimbursed by the employer (cents per kilometre basis)	4,400
Entertainment allowance from employer	2,000
Employer-paid holiday	5,000
	\$
<b>Expenses</b>	\$
Work-related car expenses (using cents per kilometre rate)	4,400
Entertainment expenses incurred on employer's business	1,000
Interest paid on bank loan used to buy shares in a listed company	750
Donation made to the Arthritis Foundation	250
Dental expenses on behalf of himself and family (himself: \$700, wife: \$1,100)	1,800
Medical expenses incurred on electronic walker for his disabled son	6,700

Jones maintains the following dependants during 2024-25:

- his wife Mary, aged 41 years, who received \$880 in interest income only, and
- his disabled son Paul, aged 20 years, a full-time student who is in receipt of a disability support pension of \$1,450 and requires Mary's full-time care.

Ted maintained private patient hospital insurance and neither he nor his spouse were in receipt of any family tax benefits for the 2024-25 tax year.

Based on the above information and assuming Ted Jones resides in Ordinary Zone B, determine his taxable income for the 2024-25 tax year and calculate his tax payable including any Medicare levy.

**Solution**

Ted Jones taxable income 2024-25 tax year

(all legislation references are to ITAA97 unless otherwise stated)

<b>Assessable Income</b>	\$	\$
Salary (s 6-5)	92,000	
Car reimbursement (s 15-70)	4,400	
Entertainment allowance (s 6-5)	<u>2,000</u>	
		98,400
<b>Deductions</b>		
Car expenses (ss 8-1; 28-25)	4,400	
Interest (s 8-1)	750	
Donations (s 30-15 — deductible gift recipient)	<u>250</u>	
		5,400
<b>Taxable income</b>		<u>93,000</u>
Tax payable on \$93,000 at 2024-25 rates		18,688.00
Less:		
DICTO <sup>1</sup>	3,008	
Zone rebate <sup>2</sup>	733.80	
		<u>3,741.80</u>
<b>Add Medicare levy (2% × \$93,000 taxable income)</b>		14,946.20
<b>TOTAL TAX PAYABLE</b>		<u>16,806.20</u>

The employer-paid holiday is neither assessable nor exempt income for the employee under ITAA36 s 23L. It is an expense payment fringe benefit and would be subject to FBT (FBTAA s 20).

The entertainment expenses are not deductible (s 32-5).

**Notes:**

(1) *Dependant invalid carer tax offset (DICTO)*  
The taxpayer and their spouse have an adjusted taxable income for offsets (ATIO) of less than \$117,194 and are therefore entitled to a DICTO (s 61-10). Mary is genuinely unable to work due to her carer obligations (ie she is wholly engaged in caring for Paul who is in receipt of a disability support pension).

$$\begin{aligned} \text{DICTO (2024-25): } & \$3,300 - [1/4 \times (\text{ATIO of the eligible dependent} - \$282)] \\ & = \$3,300 - [1/4 \times (\$1,450 - \$282)] \\ & = \$3,008.00 \end{aligned}$$

# Chapter 8

## PARTNERSHIPS

- Net partnership income ..... 18-000
- Calculation of net partnership income; distribution to partners ..... 18-020
- Calculation of net partnership income; capital gain ..... 18-040
- Partnerships; CGT assets ..... 18-060
- CGT; admitting a new partner ..... 18-080
- Retiring partners; distributions ..... 18-100
- Uncontrolled partnership income; penalty tax ..... 18-120
- Disposal of partner's interest ..... 18-140
- Variation of partnership interests ..... 18-160
- Assignment of partnership interests ..... 18-180
- Residence; profit and loss sharing ..... 18-200
- Work in progress; trading stock ..... 18-220
- Admission of new partner; ABN/TFN requirements ..... 18-240
- Tax returns; income; interest; change in partnership ..... 18-260

To determine the net income of the partnership under ITAA36 s 90, the net operating profit of \$150,000 must be adjusted. The adjustments take into account outlays that are not expenses of the partnership but are merely means by which the partners have agreed to distribute partnership profits. Such outlays are not deductible to the partnership under ITAA36 s 81 ( taxation ruling TR 2005/17). These outlays are the partner's salaries, superannuation payments and interest on capital accounts or current accounts.

Net income of the partnership is:

Net operating profit	150,000
Add:	
Interest on capital (Tim)	13,500
Salary (Caitlin)	32,000
Superannuation (Caitlin)	3,000
Interest on capital (Caitlin)	4,500
<b>NET INCOME</b>	<b>203,500</b>

Interest on a loan is deductible to the partnership where it is incurred in borrowing money applied to the use of producing assessable income (ITAA36 s 8-11). Tim had contributed the money as working capital. Although Tim's

It was whether Holding Co qualified as an ESIC under the principles of s 129. The AAT found that Holding Co was not an ESIC, mainly because its activities were to finance and oversee the corporate group by providing loans to Holding Co and generate income from potential dividends from its subsidiaries rather than trading in its own right. It was Trading Co that was undertaking the development and commercialisation of the software, not Holding Co. The AAT rejected the arguments that each company in the group was on the same overall business, instead finding that each engaged in a different function, with those of Holding Co not meeting the criteria for being an ESIC.

It appears that Grace Investments faces the same hurdles that Holding Co did in *ZWBX v FC of T*. While Grace Trading Pty Ltd might well be considered the criteria to be an ESIC, Grace Investments Pty Ltd (which is a company that John is being invited to invest in) almost certainly does not. The outcome of the case highlights the need for John to ensure that even if the company that he plans to invest in (which are purporting to be ESICs) passes the relevant tests prior to claiming the ESI tax incentives.

At an early stage and innovation tests are self-assessed, an ESIC is required to file an early stage innovation company report with the ATO if it is to be eligible for one or more investors during a financial year that could be an asset for being entitled to access the early stage investor tax incentives. ATO may claim an offset without appropriate advice or a company that is very high risk. (TBR) is very high risk.

However, the ESI tax incentives in relation to their activities. The company is not an ESIC, the tax offset and modified CCT payment for the business. A shareholder who does not apply for the ESI tax incentives and relies solely on assertions by the company as at a time of taking the reasonable care and this could be subject to penalties, in addition to the tax incentives.

## ¶8-000 Net partnership income

### Issue

T&C Printing is a stationery store operated in partnership by Tim and Caitlin. The partnership agreement provides the following:

- an annual salary of \$35,000 to Caitlin for working full-time in the business
- a superannuation payment for Caitlin equal to 10% of Caitlin's annual salary
- interest to be paid at the rate of 15% on each partner's capital contribution with Tim contributing \$90,000 and Caitlin \$30,000 respectively,
- apart from the above, Tim and Caitlin otherwise share partnership profits equally, and
- interest at the rate of 12% pa to be paid on any loan made to the partnership. Tim contributed \$15,000 to the business as working capital on 1 May 2025.

The net profit of the partnership after allowing for these outlays and other operational expenses was \$150,000 for the year ended 30 June 2025.

Calculate the net income of the partnership under ITAA36 s 90 for the year ended 30 June 2025 and the distribution to both Tim and Caitlin.

### Solution

To determine the net income of the partnership under ITAA36 s 90, the net operating profit of \$150,000 must be adjusted. The adjustments take into account outlays that are not expenses of the partnership but are merely a means by which the partners have agreed to distribute partnership profits. Such outlays are not deductible to the partnership under ITAA97 s 8-1 (*Taxation Ruling TR 2005/7*). These outlays are the partners' salaries, superannuation payments and interest on capital accounts or current accounts.

Net income of the partnership is:

	\$
Net operating profit	150,000
Add:	
Interest on capital (Tim)	13,500
Salary (Caitlin)	35,000
Superannuation (Caitlin)	3,500
Interest on capital (Caitlin)	4,500
<b>NET INCOME</b>	<u>206,500</u>

Interest on a loan is deductible to the partnership where it is incurred in borrowing money applied to the use of producing assessable income (ITAA97 s 8-1(1)). Tim had contributed the money as working capital. Although Tim is

¶8-000

a partner, on the basis that the money lent is applied as working capital and used in gaining assessable income of the partnership, the interest on the loan is deductible to the partnership. Therefore, the interest on the loan is not added back in calculating the net income of the partnership. In *FC of T v JD Roberts*; *FC of T v Smith* 92 ATC 4380, interest paid by a partnership on money borrowed to replace working capital used by the partnership in its business to earn assessable income was deductible.

The distribution of the net income of the partnership of \$206,500 between the partners is as follows:

<b>Tim</b>	\$
Salary	13,500
Interest on capital	75,000
Equal share of residual net income*	<u>88,500</u>
<b>Caitlin</b>	\$
Salary	35,000
Superannuation	3,500
Interest on capital	4,500
Equal share of residual net income*	<u>75,000</u>
	<u>118,000</u>

\* Share of residual =  $(\$206,500 - \$13,500 - \$35,000 - \$3,500 - \$4,500) = \$150,000 / 2 = \$75,000$ .

The interest on the loan provided by Tim as working capital is included in Tim's assessable income under ITAA97 s 6-5 as ordinary income and does not form part of his distribution of the net income of the partnership.

AMTG: ¶5-070, ¶5-090, ¶5-130, ¶11-200

## ¶8-020 Calculation of net partnership income; distribution to partners

### Issue

James Ney is a retired public servant. Wishing to remain active, he and his wife, Joanne, invested in a clothing shop that is managed by their 25-year-old daughter, Lisa, in partnership with her parents.

James and Joanne each contributed \$50,000 capital to the business.

The partnership agreement provides the following:

- James and Joanne will each receive interest at the rate of 15% per annum on their capital contribution.
- Lisa will receive a salary of \$35,000 per annum for the management of the business, and \$4,000 per annum will be paid by the business into a superannuation fund for Lisa.

- A car will be leased for the business.
- All residual profits and losses will be shared equally between the 3 partners, James, Joanne and Lisa.

During the year ended 30 June 2025, the partnership records show:

Sales	\$ 400,000
Cost of goods sold	220,000
Interest on capital contributions — James and Joanne	15,000
Salary — Lisa	35,000
Superannuation — Lisa	4,000
Lease of car	9,000
Other expenses — all deductible	20,000

The leased car has been used solely by Lisa, who has used the car 90% for business and 10% for private use.

What is the ITAA36 s 90 net income of the partnership?

**Solution**

The net income of the partnership for the year ended 30 June 2025 is as follows:

	\$	\$
Sales		400,000
Less:		
Cost of goods sold	220,000	
Lease of car — 90% business use	8,100	
Other deductions	<u>20,000</u>	<u>248,100</u>
<b>NET INCOME</b>		<u><b>151,900</b></u>

The distribution between the partners is:

James			
Interest on capital	7,500		
Share of residual*	<u>32,633.33</u>	40,133.33	
Joanne			
Interest on capital	7,500		
Share of residual*	<u>32,633.33</u>	40,133.33	
Lisa			
Salary	35,000		
Superannuation	4,000		
Share of residual*	<u>32,633.33</u>	71,633.33	

\*Share of residual =  $(\$151,900 - \$7,500 - \$7,500 - \$35,000 - \$4,000) = \$97,900 / 3 = \$32,633.33$

A partner cannot be an employee of the partnership, nor can a partner employ himself or herself. Therefore, there is no fringe benefits tax on Lisa's private use of the partnership car. The cost associated with the private use is not deductible to the partnership.

In determining the s 90 net income of the partnership, payments by a partnership to a partner by way of salary, the distribution of interest on capital contributions, or payments to a superannuation fund as contributions on behalf of a partner, are not deductible expenses of the partnership. They are merely a means by which the partners have agreed to distribute partnership profits.

AMTG: ¶5-070, ¶5-090, ¶5-130

**¶8-040 Calculation of net partnership income; capital gain**

**Issue**

Jack Haufmann and Dustin Nikolai are equal partners in a partnership. Both have contributed equal amounts of capital. Jack is a silent partner while Dustin spends most of the time working in the partnership business. To reflect the extra time that Dustin spends in the business, they have agreed that Dustin should receive an annual salary of \$40,000.

The bookkeeper has provided the following information in relation to the partnership for the 2024–25 tax year:

	\$
Sales	500,000
Cost of sales	200,000
Other expenses (including Dustin's salary of \$40,000)	100,000
Capital gain: profit on sale of land held as an investment	120,000

What is the ITAA36 s 90 net income of the partnership?

**Solution**

The s 90 net income of the partnership is calculated as follows:

	\$	\$
Sales		500,000
Less:		
Cost of sales	200,000	
Other expenses	<u>100,000</u>	300,000
Add back non-deductible salaries:		
Salary — Dustin		<u>40,000</u>
<b>NET INCOME</b>		<u><b>240,000</b></u>

The salary payable to Dustin is not an expense deductible under ITAA97 s 8-1. It is merely a means of distributing partnership income (Taxation Ruling TR 2005/7).

The net income of the partnership would be distributed between the partners as follows:

	Jack	Dustin	Total
	\$	\$	\$
Salary	Nil	40,000	40,000
Equal share of residual net income*	100,000	100,000	200,000
	<u>100,000</u>	<u>140,000</u>	<u>240,000</u>

\* Share of residual =  $(\$240,000 - \$40,000) = \$200,000 / 2 = \$100,000$ .

The capital gain on the sale of the land does not form part of the partnership's net income but is taken to have been made by the partners individually (ITAA97 s 106-5). Therefore, Jack and Dustin must calculate any resulting capital gain by reference to the partnership agreement and include the gain in their own individual tax return. On the basis that Jack and Dustin are partners who contributed equally into the partnership, and have the same cost base for their fractional interest in the land, they each include a \$60,000 capital gain in their tax return.

AMTG: ¶5-070, ¶5-090, ¶5-130, ¶11-200

## ¶8-060 Partnerships; CGT assets

### Issue

The Dale partnership is in the business of manufacturing shelters for pets. The partnership was formed by Graham, Martha, Joan and Cate Dale in June 2013 with each partner holding equal shares. At that time, the partners made the following contributions:

- Graham — a small factory to manufacture the shelters with a market value of \$500,000. The factory was acquired by Graham before 20 September 1985.
- Martha — a warehouse for storage of the shelters with a market value of \$200,000. She also contributed \$300,000 in cash.
- Joan — registered designs for the pet shelters and \$100,000 in cash.
- Cate — \$500,000 in cash.

In July 2014, the partnership purchased a shop for \$800,000 to sell the pet shelters.

In August 2024, Graham decides to retire from the partnership. At this time the market value of the partnership assets is:

Assets	\$
Small factory	1,000,000
Warehouse	600,000
Pet shelter designs	nil
Shop	1,200,000

The value of the trading stock on hand when Graham retires is \$3 million. Martha, Joan and Cate agree to pay Graham \$2.1 million (\$700,000 each) for his interest in the partnership, with all the assets to remain in the new partnership.

What are the capital gains tax (CGT) consequences for Graham upon retiring from the partnership?

### Solution

CGT will only apply in relation to a CGT event that occurs to a CGT asset. A CGT asset is defined to include:

- (1) an interest in the asset of a partnership, and
- (2) an interest in a partnership not covered by (1) (ITAA97 s 108-5(2)).

A capital gain or loss from a CGT event happening in relation to a partnership or a partnership's CGT asset is attributed to the partners individually and not to the partnership. On Graham's retirement, Martha, Joan and Cate are taken to have acquired a separate CGT asset when they acquire a share of Graham's interest in a partnership asset (ITAA97 s 106-5). Accordingly, the disposal of Graham's interest in the assets of the partnership can result in capital gain or capital loss to Graham. The money received by Graham is allocated among various assets to the extent it relates to the assets of the partnership or his interest in the partnership. Based on this application of the law, the CGT consequences arising for Graham upon retiring from the partnership are as follows:

### Small factory

On entering the partnership, Graham has disposed of 3/4 of his interest in the factory (ie 1/4 each to the other 3 partners). His remaining 1/4 share in the building remains a pre-CGT asset. The 1/4 shares belonging to the other partners are post-CGT assets.

By leaving the partnership, the disposal of Graham's interest in the factory to the remaining partners triggers CGT event A1. The capital proceeds are determined to be \$250,000 being 1/4 of the market value. However, as the interest in the factory is a pre-CGT asset in the hands of Graham, the capital gain is disregarded.

### Warehouse

On entering the partnership, Graham acquired 1/4 share in the warehouse from Martha. The cost base of his interest in the warehouse is \$50,000. On leaving the partnership, the disposal of his interest in the warehouse to the remaining partners also triggers a CGT event A1 with capital proceeds of \$150,000 based on Graham's 1/4 share at market value.