¶1-000 Assessable income; royalties

Issue

Creativity Pty Ltd (CPL) is an Australian based company in the business of creating content for print books, eBooks and short films. In July 2016 CPL entered into a contract with a US-based company, Digital Media Inc (DMI), for the provision of technical expertise in relation to the storage of that content. Under the contract CPL would pay DMI an initial lump sum and a fee for each occasion on which CPL sought technical advice.

In August 2016 CPL finalised content for a book on Australian landscapes and assigned copyright to print the book to a publishing house in return for a 10% fee for each book sold. In September 2016, CPL assigned the film rights to the book to Film Oz Pty Ltd for a lump sum, based on a pre-estimate of each occasion on which the film would be shown.

Do any of these payments constitute royalties and if so, what are the tax consequences?

Solution

For income tax purposes a royalty, which is within the common law meaning of the term, would be ordinary income and assessed under ITAA97 s 6-5. Royalties are given an extended meaning under the definition of "royalty" or "royalties" in ITAA36 s 6(1) and may also be included in the assessable income of a taxpayer under ITAA97 s 15-20 or treated as a capital gain.

The High Court in *Stanton v FC of T* (1955) 92 CLR 630 defined the essence of a royalty as payments "made in respect of the particular exercise of the right to take the substance and therefore should be calculated either in respect of the quantity of value taken or the occasions on which the right is exercised".

Copyright assignment — 10% fee

The 10% fee received by CPL for their assignment of copyright and based on the number of books sold fits the definition of a royalty and will be assessed as ordinary income under s 6-5.

Lump sum payment for anticipated future use

A lump sum payment based on a pre-estimate of the anticipated future use may also be a royalty. The lump sum received by CPL in return for assigning the film rights to the book to Film Oz Pty Ltd may qualify as a royalty because it is based on a pre-estimate of future use, ie future screenings. This payment would then be assessable as ordinary income under s 6-5. Alternatively, ITAA97 s 15-20 would include in the assessable income of CPL an amount received by way of royalty within the ordinary meaning of "royalty" not assessable as ordinary income under s 6-5. If the lump sum was held not to be a royalty within the ordinary meaning of the term it could still be included in assessable income as a capital gain, given that intellectual property does constitute an asset for CGT purposes.

Lump sum and fee payment to DMI

In relation to the lump sum and fee payments made to DMI for the provision of technical expertise, two earlier decisions, ie *FC of T v United Aircraft Corporation* (1943) 68 CLR 525 and *FC of T v Sherritt Gordon Mines Limited* 77 ATC 4365, held that payments for the provision of technical assistance were not royalties. However, under the extended definition of royalties in s 6(1), payments such as those made to DMI are now included as royalties.

The issue in relation to the royalty payments to DMI is whether these payments are foreign source income or Australian source income in the hands of DMI. Payments made to the non-resident US-based DMI, under an agreement for the supply of technical expertise sourced from the US, would be foreign source income. However, under ITAA36 s 6C, the royalties received by DMI are deemed to have an Australian source and would be subject to withholding tax payable by CPL at the rate specified in Australia's double tax agreement with the US, ie 5%.

AMTG: ¶10-510, ¶21-060, ¶21-070, ¶22-030

¶1-020 Sharing economy; rental marketplace; Airbnb

Issue

In June 2016 Orpheus Parker purchased a ground floor two-bedroom townhouse in Neutral Bay, Sydney. He decided to rent out part of his townhouse on Airbnb while still living in the property. The total floor area of the townhouse is 850 sq feet (79 m^2). The floor space of Orpheus' bedroom and his private area is 250 sq feet (23.2 m^2). The rented second bedroom area is 200 sq feet (18.6 m^2). The shared area comprising lounge, kitchen and laundry cupboard is 400 sq feet (37.2 m^2).

The property has been listed since 1 September 2016 and Orpheus has achieved consistent occupancy rates. During the period of 1 September 2016 to 30 June 2017, the room was rented for 150 days. Orpheus only offered the room to solo travelers and he has received a total of $22,500 in rental income. During this period, expenses relating to occupancy costs, such as mortgage interest, municipal rates, strata levies and home insurance amounted to $50,000. Orpheus also spent $250 on expenses relating to renting the room, ie advertising fees and consumables supplied for the room.

Advise Orpheus of the tax consequences of using his townhouse to produce rental income for the 2016/17 income year.

Solution

Rental income and deductions

The income that Orpheus receives under a lease and hiring charges is assessable as ordinary income (ITAA97 s 6-5) and, accordingly, the $22,500 income should be included in his tax return for the 2016/17 income year. Since the $22,500 rental income is included as assessable income, expenses relating to the income are allowable as a deduction (ITAA97 s 8-1).

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As Orpheus still lives in the townhouse, any tax deductions must be apportioned to only the income-producing portion as some of these expenses relate to private use by Orpheus. It would be reasonable to consider that expenses relating to the second bedroom and a share of the lounge, kitchen and laundry cupboard would be directly related to the income-producing activity.

Where expenses can be directly related to the second bedroom, then the deduction would be allowed in full, otherwise expenses would be calculated on the basis of the number of days the property was rented out and the proportion of the floor area that is rented (and shared).

The apportionment of the deduction is based on the total occupancy percentage of 47% (ie (18.6 + 37.2 / 2) / 79). This includes the rented second bedroom area and a 50% share between Orpheus and the guest of the spared area (ie lounge, kitchen and laundry cupboard). The allowable deductions available against the income received are deductible at a rate of 47% for each night a guest stays at the property.

The expenses that relate to occupancy costs, such as mortgage interest, municipal rates, strata levies and home insurance premiums are relevant and incidental to the derivation of rental income. As occupancy costs relate to a property as a whole, they must be apportioned between the income-producing purpose and the private purpose. Applying the occupancy percentage against the number of days the townhouse was used for income-producing purposes in the income year (150 days), the allowable deduction for the 2016/17 income year is $9,658 calculated as follows:

$50,000 × 150 / 365 × 47% = $9,658

Note that this apportionment takes into account that the room was only available to rent for 10 months of the year.

Orpheus can deduct, with any apportionment, the expenses relating to the actual rental of the room, such as the advertising fees paid and any consumables supplied for the room.

The taxable income that Orpheus is required to declare in his 2016/17 tax return is $12,592 (ie $22,500 – ($9,658 + $250)).

Orpheus is also permitted to deduct the decline in value for any furniture, fixtures and appliances used in the townhouse using the same apportionment methodology. A schedule from a quantity surveyor would need to be prepared and the cost of preparation may be prohibitive compared to the deduction available.

GST registration

Fortunately for Orpheus, the provision of residential accommodation is input taxed and the property is used predominantly for private purposes (GST Act s 40-35). Accordingly, there is no GST liability as this type of supply is not included in the turnover test for GST registration (GST Act s 23-5). Unlike other sharing economy participants such as Uber drivers, Orpheus is not required to be registered for GST.

AMTG: ¶2-135, ¶10-055, ¶10-105, ¶16-010, ¶30-005

¶1-040 Social media income; professional artist business

Issue

Catherine Wise works full-time in sales. For the past three 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, ie 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 barrier 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 have however 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

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- 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 such that it is described as making a profit, 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 activities of "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 (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) 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 transgressed 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 her business are to be included in her assessable income, and deductions will be allowable for all expenses of a revenue nature incurred in the course of deriving that income.

If the online business is going well, then she must include the taxable income from the business in her tax return along with her salary and wages from her sales assistant job. However, if she is making a loss from her online business, then this loss may not be able to offset her taxable income derived from her sales assistant role. The non-commercial business loss integrity provisions under 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 Hunter Valley. In November 2016, a bushfire caused major damage in and around the region and Speedy was closed until April 2017.

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. After providing substantiation, Jasper received $200,000 on 23 June 2017 as a payout 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 $50,000 for Speedy in February 2017.

Are Jasper or Speedy required to declare any of these amounts as assessable income in either of their 2016/17 tax returns?

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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).

As the insurance payment was received on 23 June 2017, Speedy should include the $200,000 payment in the 2016/17 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 2016/17 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 2014/15 income year she misappropriated $360,000 worth of company funds.

In the 2016/17 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 2016. She was issued a court restitution order to repay $300,000 to E Corp. She was also fined $120,000.

In January 2017, 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 2014/15 income year and pay any shortfall interest amounts and penalties associated.

Losses or outgoings necessarily incurred in carrying on illegal or *ultra vires* business will be deductible, according to 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 outgoing incurred in deriving that income.

On this basis, Natasha is not permitted to deduct the restitution amount of $300,000 in the 2016/17 income year. However, since the amount directly relates to assessable income of $360,000 previously recognised in the 2014/15 income year, the $300,000 is permitted to reduce the $360,000 from the 2014/15 income year. Accordingly, additional assessable income for the 2014/15 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 2016/17 income year.

Natasha would also be required to include the $50,000 from the television interview in her assessable income for the 2016/17 income year as the appearance was part of her "business activities" and there was a view to a 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 bulk petrol and oil products under an agreement with Mid-Eastern Oil (MEO) for which AOD pays MEO $1m 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 $2m from MEO for the impact on its business arising from breach of the agreement.

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The action against MEO was subsequently settled with MEO agreeing to pay AOD a lump sum of $1.5m 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 two 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 $1.5m from MEO.

Solution

In general, compensation takes on the character of what it replaces (*C of T (NSW) v Meeks* (1915) 19 CLR 568 and *Heavy Minerals Pty Ltd v FC of T* (1966) 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 $1.5m 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 $1.5m payment, ie 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 $1.5m is unliquidated damages and cannot be dissected into income and capital components then the entire amount will be assessable income under the capital gains tax provisions. The capital gain being the disposal of the asset, ie AOD's right to sue for damages (*Taxation Ruling* TR 95/35).

However, if the $1.5m 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, namely CGT event D1 (ITAA97 s 104-35(1)).
- The amount assessed as compensation for damage to business reputation will be of a capital nature and taxed as a capital gain. The underlying asset being business goodwill (*FC of T v Murry* 98 ATC 4585).

AMTG: ¶10-020, ¶10-114, ¶10-115, ¶10-170, ¶10-175, ¶11-280

¶1-120 Strata title body corporate; mutuality principle

Issue

The Eumeralla Road Body Corporate (Eumeralla) has been established to control, manage and administer ten separate strata titled residential units and associated common property. The strata title and body corporate has been registered and governed in Victoria under the *Owners Corporations Act 2006* (Vic) and *Subdivision Act 1988* (Vic).

Each owner (proprietor) has a title comprising a two bedroom unit and a car park. The common property includes additional car parking, driveways, garden, as well as unit access areas.

During the 2016/17 income year, the following income was received by Eumeralla:

- monthly fees contributed by each proprietor to the body corporate common fund
- a fine paid by one proprietor who breached the by-laws — equivalent to one month of fees
- interest on late payment of monthly fees
- interest on the Eumeralla Common Fund bank account, and
- lease fees of $200,000 received from a billboard advertising company placing advertising on the outside facing wall (common property).

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What is the tax treatment for income received by Eumeralla and/or the proprietors for the 2016/17 income year?

Solution

A strata title body is a company for income tax purposes (*Taxation Ruling* TR 2015/3). A strata title body corporate is constituted by the proprietors but is a separate legal entity with specified powers, authorities, duties and functions. These include:

- the power and authority to impose a levy on the proprietors, to make by-laws, to carry out necessary work, to invest and to borrow, and
- the duty and function to control, manage and administer the common property, to maintain the common property and keep it in a good state of repair, to effect insurances on the building and common property and to keep records and books of account.

The tax treatment of the income amounts received by Eumeralla is as follows:

Monthly fees

The principle of mutuality applies where an amount will not be included in its assessable income under ITAA97 s 6-5 that is otherwise assessable to the strata title body corporate.

Amounts levied on proprietors by a strata title body in accordance with the state or territory Acts which form part of a fund used for the day-to-day expenses, general maintenance and repair of common property or for the establishment of special purpose funds as set out under those Acts are mutual receipts and are not assessable to Eumeralla (TR 2015/3).

Fines for breaching Eumeralla by-laws

The amount paid to Eumeralla by the proprietor was paid outside the normal capacity as member of the body corporate. Accordingly the mutuality principle does not apply. This amount will be considered assessable income of Eumeralla under ITAA97 s 6-5.

Interest on late payment of monthly fees

The payment of the monthly fees represent the proprietor's share in the mutual liabilities of Eumeralla and are considered mutual receipts. The interest is imposed to compensate the other proprietors for a measurable detriment suffered by the common fund. On this basis, the interest amount is akin to the monthly fees and treated as a mutual receipt. The interest is non-assessable to Eumeralla.

Interest on bank account

The income from the bank account is a non-mutual receipt and assessable income to Eumeralla.

Lease fees from advertising company

Under Victorian legislation, common property is owned by the proprietors and not owned by the body corporate as trustee. Similar rules apply in other states and territories under strata legislation. Accordingly, income from common property is assessable to the proprietors and not Eumeralla. In this case, each of the proprietors would include the tenth share of the $200,000 ($20,000) as assessable income.

Tax return

Eumeralla is required to lodge a strata title body corporate tax return and include the income from the fines and the bank interest as assessable income. Eumeralla is permitted to pay franked dividends to the proprietors.

AMTG: ¶3-550, ¶3-810

¶1-140 Mutuality principle; taxable income on apportionment of expenses

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Issue

The Pankhurst Panthers are a licensed AFL women's football club operating since 1903. They have an active social club that provides food and beverages to members after training and game days. With the introduction of the AFL women's league in 2017, there has been more interest in women's football and they regularly have guests being signed in by members to various functions.

The club's financial records for the 2016/17 income year show the following:

		$
Income		
	Membership fees	60,000
	Trading	675,000
	Investment	175,000
	Sponsorship by the local independent grocery store	250,000
Expenses		$
	Uniforms, training equipment, insurance and AFL fees	157,500
	Food and beverage expenses	425,000
	Investment	17,500

The club cannot directly identify the food and beverage income or expenses that relates to members and non-members. The club had 120 members for the year. There were 80 non-members that signed in for functions during the year of which 60 were member guests and 20 were visitors. On average 50 members attended each game day and recovery session. The club was open each Saturday and Sunday for 25 weeks.

What is the taxable income of the Pankhurst Panthers for the 2016/17 income year?

Solution

A club whether incorporated or not is treated as a company for tax purposes. Taxable income is defined as the difference between assessable income (ITAA97 s 6-5) and allowable deductions (ITAA97 s 8-1).

Income

Clubs are owned by their members and provide funds for a common purpose. The principle of mutuality recognises that a person's income consists only of moneys derived from external sources, so any money supplied by a member to the club would not be considered income (*Taxation Ruling* TR 2015/3).

As a general principle, where a number of people contribute to a common fund created and controlled by them for a common purpose, any surplus arising from the use of that fund for the common purpose is not income (*Colonial Mutual Life Assurance Society Ltd v FC of T* (1946) 73 CLR 604, *The Social Credit Savings & Loans Society Ltd v FC of T* 71 ATC 4232). As a mutual receipt cannot be treated as "income", it does not form part of "exempt income".

Accordingly, a club would only be assessable on the trading income relating specifically to non-members and on income received from sources outside its general trading activities (*Bohemians Club v Acting FC of T* (1918) 24 CLR 334).

Deductions

Under ITAA97 s 8-1, expenditure incurred in gaining or producing assessable income is an allowable deduction, except to the extent that it relates to gaining exempt income or is of a capital, private or domestic nature. Accordingly, expenses incurred by a club can be classified for income tax purposes as follows:

a) Non allowable: expenses relating specifically to members.

b) Wholly allowable: expenses relating specifically to non-members and expenses relating to wholly assessable income (eg investment expenses).

c) Partly allowable: expenses which are apportionable between members and non-members. The allowable proportion may be determined by applying the non-member percentage to the expenses incurred. The following formula, from the decision in *"The Waratahs" Rugby Union Football Club v FC of T* 79 ATC 4337 (the Waratahs' Formula) is used for providing clubs with a basis for calculating the non-member percentage:

$$(B \times 75\%) + C \;/\; ((R \times S \times T) + A) \times 100 \;/\; 1$$

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Where:

A = total visitors for the year of income

B = members' guests, ie those visitors who are accompanied to the club by a member and signed in by that member

C = A – B

R = the average number of subscribed members in the year of income

S = the percentage of members who attended the club on a daily basis

T = the number of trading days in the year of income.

Applying these rules to the Pankhurst Panthers, the non-member percentage is:

$$(60 \times 75\%) + (80 - 60) \;/\; (120 \times 50/120 \times 50) + 80 \times 100/1$$

$$= 65 \;/\; (2{,}500 + 80) \times 100/1$$

$$= 2.52\%$$ (the "non-member percentage").

The mixed taxable income that cannot be identified is $250,000, ie $675,000 (trading income) *less* $425,000 (food and beverage expenses).

The taxable income attributed to non-members and treated as taxable income by the club is calculated by applying the non-member percentage to the mixed taxable income, ie $250,000 × 2.52% = $6,300.

The amounts that are considered mutual are the membership fees, and accordingly, the uniforms, training equipment, insurance and AFL fee amounts are non-deductible as they have not been incurred in producing assessable income.

The remaining amounts are from external sources and should be treated as taxable income.

The taxable income for the 2016/17 income year is $413,800 calculated as follows:

		$
Income		
	Investment	175,000
	Sponsorship by the local independent grocery store	250,000
	Non-member attribution based on Waratah's ratio	6,300
		431,300
Less: Expenses		
	Investment	17,500
	TAXABLE INCOME	$413,800

AMTG: ¶3-810, ¶3-820, ¶3-830

¶1-160 Excess superannuation contributions

Issue

Liz Masselli is aged 41 and runs her own landscaping business. Her taxable income from business activities is $101,000 for 2016/17. Liz is an Australian resident with sufficient private health insurance.

For the 2016/17 financial year, Liz contributes $33,000 to her superannuation fund and claims a tax deduction for all of the contributions.

What are the tax consequences for Liz of the $33,000 contribution?

Solution

If an individual claims a tax deduction for contributions made on their own behalf to a superannuation fund, the contributions are "concessional contributions". An individual also has concessional contributions if an employer makes contributions for that individual.

An individual has *excess concessional contributions* for a year if their concessional contributions exceed their *concessional contributions cap* for the year (ITAA97 s 291-20). For an individual aged under 50, the concessional contributions cap is $30,000 for 2016/17.

The consequences for an individual of having excess concessional contributions are:

- the excess concessional contributions are included in assessable income and taxed at ordinary tax rates (s 291-15(a))
- a non-refundable tax offset equal to 15% of the excess concessional contributions reduces the tax liability (s 291-15(b))
- excess concessional contributions charge may be payable (TAA Sch 1 s 95-10), and
- the excess concessional contributions retained in the superannuation fund are treated as non-concessional contributions.

An individual may elect to release from superannuation up to 85% of their excess concessional contributions for the year (TAA Sch 1 s 96-5). The amount is capped at 85% because the remaining 15% represents the tax liability that the fund incurred when it received the contributions. The amount would be paid by the individual's superannuation fund to the Commissioner (TAA Sch 1 s 96-20) who would credit the amount against the individual's tax liability (TAA Sch 1 s 96-50). The released amount is non-assessable non-exempt income (ITAA97 s 303-15).

Tax consequences for Liz from the excess concessional contributions

The tax consequences for Liz when she has taxable income of $101,000 and concessional contributions of $33,000 for 2016/17 are as follows:

1. Liz has excess concessional contributions of $3,000 because the concessional contributions cap for an individual aged under 50 years is $30,000.
2. The $3,000 excess concessional contributions are included in Liz's assessable income and taxed at her ordinary tax rates.
3. The tax on $104,000 (ie $101,000 + $3,000) is $26,112.
4. Liz is entitled to a non-refundable tax offset equal to $450 (ie 15% of $3,000), which reduces her tax liability to $25,662 (ie $26,112 – $450). Medicare levy is $2,080 (ie 2% of $104,000), meaning that her total tax payable is $27,742.
5. Liz is liable to pay excess concessional contributions charge because her tax liability exceeds what would have been her tax liability if the excess contributions had not been included in her assessable income. As a result of the excess concessional contributions, Liz's taxable income has increased by $3,000 and her additional tax is $720 (ie $3,000 × 37% + $3,000 × 2% – $450).

   Excess concessional contributions charge is payable on $720. The charge is calculated daily and the rate is based on the monthly average yield of 90-day Bank Accepted Bills published by the Reserve Bank plus a 3% uplift factor (*Superannuation (Excess Concessional Contributions Charge) Act 2013* s 4).

Liz may elect to release from superannuation up to $2,550, ie up to 85% of her excess concessional contributions for the year. The amount would be paid by Liz's superannuation fund to the Commissioner who would credit the amount against Liz's tax liability. The released amount is non-assessable non-exempt income.

Where an amount is released from Liz's superannuation fund, that amount (grossed-up for the contributions tax) is no longer counted as a non-concessional contribution. If Liz elected to release the full amount of $2,550, then the full $3,000 would no longer be counted as a non-concessional contribution.

AMTG: ¶13-777, ¶13-780

¶1-180 Income or capital; mere realisation or carrying on a business

Issue

In 1975, Joe Messina purchased five hectares of land 40 km from Sydney's CBD. The land was used for agricultural pursuits, with produce sold through Sydney markets.

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In the year 2000 the government proposed construction of an airport adjacent to Joe's land. Subsequently, in 2005 Joe sold the land for $700,000 and used this entire amount to acquire a large block of land closer to Sydney with the intention of keeping the land as a retirement nest-egg.

In 2014, Joe was approached by a real estate developer to construct eight townhouses on the land. Joe accepted the proposal and employed architects, builders and obtained development approval from the local council. Joe oversaw the development and engaged real estate agents to market the townhouses for sale upon completion.

During the course of the 2016/17 income year seven townhouses were sold for $650,000 each. Joe retired to the remaining townhouse.

Advise Joe Messina on whether the proceeds from his land and building transactions constitute assessable income and the basis on which they may be assessed.

Solution

Sale of the five hectares; income or capital

Assessable income consists of ordinary income and statutory income (ITAA97 s 6-1(1)). Ordinary income is assessable under ITAA97 s 6-5(1), whereas statutory income is assessable under specific provisions, such as those relating to capital gains, ie ITAA97 Pt 3-1 and 3-3. An amount may be assessable as both ordinary and statutory income, in which case the specific provisions will apply (ITAA97 s 6-25). An example may be the disposal of an asset, such as land. The amount received may be assessed as ordinary income where the taxpayer is carrying on the business of land development (see *FC of T v Whitfords Beach Pty Ltd* 82 ATC 4031) or statutory income, eg capital gain where the taxpayer is merely disposing of a parcel of land (see *Statham & Anor v FC of T* 89 ATC 4070).

Joe Messina's original five hectares of land is a pre-CGT asset and can be disposed of free of CGT. However, a further issue must be considered, ie whether the sale of the land was a mere disposal of an asset or the proceeds from carrying on a business. Proceeds from the mere disposal of an investment are not assessable income (*Scottish Australian Mining Co Ltd v FC of T* (1950) 81 CLR 188), whereas the proceeds from carrying on a business are assessable as ordinary income. Even an isolated transaction or an extraordinary transaction may be assessable (*FC of T v Whitfords Beach Pty Ltd* 82 ATC 4031; *FC of T v The Myer Emporium Ltd* 87 ATC 4363).

In Joe's case the purchase and sale of the land does not meet the indicia for carrying on a business (*Californian Copper Syndicate Ltd v Harris (Surveyor of Taxes)* (1904) 5 TC 159). Joe did not enter into the transaction to sell the land with the intention to make a profit (*Whitfords Beach; Myer Emporium*). The factors the Commissioner considers in determining whether an isolated transaction amounts to a business are set out in *Taxation Ruling* TR 92/3.

Hence, the $700,000 proceeds from the sale of the land are not assessable income. They are exempt from CGT and do not result from carrying on a business or constitute an isolated or extraordinary transaction on the authority of *Whitfords Beach* and *Myer Emporium*. The amount is not assessable on the principle that the proceeds from the mere realisation of a capital asset are not assessable as ordinary income (*Statham & Anor v FC of T* 89 ATC 4070; *Casimaty v FC of T* 97 ATC 5135; *McCorkell v FC of T* 98 ATC 2199).

Sale of the townhouses

The acquisition of the large block of land constitutes a post-CGT asset, with a cost base of $700,000. The sale of the seven townhouses constitutes the disposal of an asset and prima facie attracts CGT. However, it may be argued that the proceeds are normal proceeds from carrying on a business.

The distinction between capital gains and carrying on a business is important because the amount of tax payable may differ. For example, capital gains may attract a 50% discount and some deductions against income from carrying on a business may not add to the cost base for CGT purposes.

The tax-free proceeds from the mere disposal of a pre-CGT asset/investment do not apply in the case of post-CGT assets/investments.

Had Joe Messina not been involved in the design, council approval, building and marketing of the completed townhouses it could not be said that he was carrying on a residential construction business — in which case the profit on the sale of the townhouses would be assessable as a capital gain and the gain, discounted by 50% would be added to Joe's assessable income for the year or years in which the sales took place. The capital proceeds would be $4,550,000. The first element in the cost base, the $700,000 purchase price for the land would need to be apportioned because Joe is retaining one of the eight townhouses for his own use.

However, on the facts, Joe Messina took an active role in the development and sale of the seven townhouses and this reflects a number of the indicia applicable to carrying on a business, including profit motive, scope of the activity, personal effort and involvement, employing or sub-contracting staff and the commercial nature of the project. Consequently, it is likely that Joe will be held to be carrying on a business and the normal proceeds from carrying on a business are assessable income (*Taxation Ruling* TR 97/11).

AMTG: ¶10-000, ¶10-020, ¶10-105, ¶10-110, ¶10-112, ¶10-120

¶1-200 Non-cash business benefits

Issue

Quantum Appliances manufactures electrical appliances which can be purchased direct from Quantum or from various large retailers. The appliances have a five-year warranty, but the warranty is only valid if installation, servicing and repairs are carried out by accredited Quantum sub-contractors.

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¶3-000 Benefits to employees, former employees and customers

Issue

Mate Co Ltd, is a manufacturer of electronic equipment. During the FBT year ending 31 March 2017 Mate Co provided the following items:

a) Shares in an employee share scheme (ESS) to a current employee.

b) Superannuation contributions paid into a former employee's complying fund pursuant to a salary sacrifice arrangement.

c) A brief case for a potential employee as an enticement to join the organisation.

d) A holiday package costing $5,500 to a customer as part of a competition.

e) The payment of an employee's personal credit card expenses of $10,000 under a salary sacrifice arrangement.

Mate Co is not entitled to any FBT concessional treatment.

Advise Mate Co as to which of these items do not fall within the meaning of "fringe benefit". For any items that constitute a fringe benefit, calculate the taxable value and the FBT payable.

Solution

(a) Shares

Shares issued to an employee under an "employee share scheme" (ESS) in which ITAA97 Subdiv 83A-B or 83A-C applies are specifically excluded from being a fringe benefit under item (h) of the definition of a fringe benefit in FBTAA s 136(1).

Broadly, an ESS for this purpose is defined under ITAA97 s 83A-10 as a scheme under which ESS interests (eg shares in a company) are provided to employees, or associates of employees (including past or prospective employees) of: (a) the company, or (b) subsidiaries of the company.

(b) Superannuation contributions

Superannuation contributions paid to a complying superannuation fund are specifically excluded from being a fringe benefit under item (j) of the definition of a fringe benefit in s 136(1).

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(c) Brief case

A brief case is an exempt fringe benefit under FBTAA s 58X(2)(d). An exempt fringe benefit is specifically excluded from being a fringe benefit under item (g) of the definition of a fringe benefit in s 136(1).

(d) Holiday package

The holiday package does not constitute a fringe benefit as it is not provided to an employee or an associate of the employee (s 136(1)).

(e) Payment of employee's personal credit card expenses

The payment of an employee's personal expenses falls within the definition of a fringe benefit under s 136(1) and the exclusions listed in that section do not apply. The fact that the benefit is provided under a salary sacrifice arrangement does not alter the outcome.

The payment of an employee's personal credit card bill constitutes an expense payment fringe benefit pursuant to FBTAA s 20. This arises where an employer pays or reimburses expenses incurred by an employee.

The FBT liability is calculated as follows:

Taxable value = $10,000

Grossed-up taxable value = $10,000 × 1.9608*

FBT payable = $19,608 × 49% = $9,608

*Grossed-up using the lower Type 2 gross-up rate as Mate Co Ltd is not entitled to claim input tax credits for GST purposes as a credit card statement by itself is not a tax invoice.

AMTG: ¶35-025, ¶35-070, ¶35-080, ¶35-330, ¶35-350, ¶35-645

¶3-020 Car fringe benefit

Issue

On 1 April 2016 Bourke Pty Ltd, a Melbourne based company, purchased a new company car at a cost of $50,000 including GST. The car was registered and insured on that date and was to be used exclusively by Tom Grant, Bourke's Business Manager. The total distance travelled by the car in 12 months was 22,000 km, 8,000 km of which was for business purposes. The car was garaged at Tom's residence.

The following costs (GST inclusive) relate to the car's use:

	$
Registration and insurance	1,300
Petrol and oil for car	3,000^
Repairs	500
Service and maintenance	400

^Tom contributed $1,500 towards the cost of the petrol and oil for the car.

Calculate the FBT liability using both the statutory formula and the operating cost methods. Which method would you recommend to Bourke Pty Ltd?

Solution

The employer, Bourke Pty Ltd has provided a company car for Tom's exclusive use. The car will be treated as being available for Tom's private use as it is garaged at his home. A fringe benefit therefore arises even though the car is also used by Tom for business or work-related travel.

Bourke Pty Ltd can use either the statutory formula method (FBTAA s 9(1)), or the operating cost method (FBTAA s 10(2)) to work out the taxable value of the car fringe benefit. However, in order to use the operating cost method the appropriate substantiation records must be kept, eg log books.

Statutory formula method

The taxable value of a car fringe benefit under the statutory formula method is calculated as follows:

$$\frac{ABC}{D} - E$$

where
- A = $50,000, the base value of the car
- B = 20%, the statutory fraction, regardless of the number of kilometres travelled (FBTAA s 9(2)(c))
- C = 365, the number of days when the car was used or available for private use
- D = 365, number of days in the FBT year, and
- E = $1,500, the employee's (recipient's) contribution.

Taxable value $= \frac{\$50{,}000 \times 0.20 \times 365}{365} - \$1{,}500 = \$8{,}500$

FBT payable = Taxable value × Type 1 gross-up factor† × FBT rate

= $8,500 × 2.1463 × 49%

= $8,939.34

† The Type 1 gross-up factor has been used because in this scenario as the employer would be able to claim GST input tax credits.

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Operating cost method (assume substantiation requirements are met)

The taxable value of a car fringe benefit under the operating cost method is calculated as follows:

$$[C \times (100\% - BP)] - R$$

where
- C = operating cost of the car
- BP = percentage of business use, and
- R = employee's (recipient's) contribution

C — operating costs of the car

	$	
Registration and insurance	1,300	
Petrol and oil for car	3,000	(includes Tom's contribution of $1,500)
Repairs	500	
Service and maintenance	400	
Deemed depreciation	12,500	($50,000 × 25%*)
Deemed interest**	2,825	($50,000 × 5.65%)
Total operating costs	$20,525	

*The deemed depreciation rate is 25%.

**Deemed interest is the base value of the car multiplied by the statutory benchmark interest rate, which is 5.65% for the 2016/17 FBT year.

BP — the business percentage

The business percentage is calculated using the formula:

$$\frac{\text{Business kilometres}}{\text{Total kilometres}}$$

$$= \frac{8{,}000 \text{ km}}{22{,}000 \text{ km}}$$

$$= 36.36\%$$

Taxable value = [C × (100% – BP)] – R

= [$20,525 × (100% – 36.36%)] – $1,500

= $11,562 (rounded)

FBT payable = Taxable value × Type 1 gross-up factor × FBT rate

= $11,562 × 2.1463 × 49%

= $12,159.61

The statutory method in this case produces a lower taxable value, therefore Bourke Pty Ltd should be advised to use that method rather than the operating cost method.

AMTG: ¶35-150, ¶35-180, ¶35-210, ¶35-240

¶3-040 Car fringe benefits; fleet vehicles; operating cost method

Issue

MediPlus Pty Ltd is in the business of selling medical equipment and prostheses to surgeons. During the 2016/17 FBT year, the company has a fleet of 25 vehicles which it provides to its employees to carry equipment for sales calls and to provide on-call assistance to surgeons at hospitals. The cars are normally garaged at the employees' homes overnight and are primarily used for work purposes.

The cars are Toyota hatchbacks which are chosen by MediPlus Pty Ltd due to fleet discounts available and their ability to carry and transport the equipment. They were purchased for a cost of $35,000 (incl GST) each during the 2015/16 income year as part of an update to the company's fleet. All expenses in relation to the running of the vehicles, such as fuel, insurance and maintenance, are met by the company.

MediPlus Pty Ltd uses the operating cost method for calculating the taxable value of its car fringe benefits. Employees of the company are required to maintain valid log books to determine the extent of any private use for the log book year. However, only 20 employees have undertaken this requirement in the log book year. The average of the business percentages of these log books is 80% for the 2016/17 FBT year.

The company is concerned that in the absence of valid log books it cannot apply the operating cost method.

For the 2016/17 FBT year, advise MediPlus Pty Ltd whether it can apply the operating cost method for determining the taxable value of the car fringe benefits for its entire fleet.

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Solution

FBTAA s 10 allows employers to elect to apply the operating cost method to work out the taxable value of car fringe benefits provided to their employees.

One aspect of the operating cost method requires the employer to work out the business use percentage applicable to each of the cars provided. To work out the business percentage of a car, an employer must ensure that log books and odometer records showing the business use of the car are maintained (s 10A).

This requirement must be completed on or before the date on which the employer's FBT return for the year is due to be lodged. An employer must retain odometer and log book records for five years from the assessment date of the last year to which they relate (FBTAA s 123; 136(1)).

An employer is required to keep a log book for the first year the operating cost method is used and then every five years. The log book must be kept for a minimum of 12 weeks.

As noted in the facts, while MediPlus Pty Ltd has a policy of requiring that all its employees maintain log books, this requirement has been satisfied by only 20 employees.

Prima facie, in the absence of valid log books to determine the business percentage for five of the cars provided, a choice cannot be made for the company to apply the operating cost method in working out the taxable value of these vehicles. The statutory formula method is the default method which would apply in calculating the taxable value for those cars.

However, *Practical Compliance Guideline* PCG 2016/10 allows employers who manage large car fleets to rely on a representative *average business use percentage* to calculate car fringe benefits for the fleet under the operating cost method.

This simplified approach applies if:

- it is an employer with a fleet of 20 or more cars
- the cars are "tool of trade" cars (ie the cars are subject to extensive business use)
- the employees are required to maintain log books in a log book year
- the employer holds valid log books for at least 75% of the cars in the log book year
- the cars are of a make and model chosen by the employer, rather than the employee
- each car in the fleet had a GST-inclusive value less than the luxury car limit applicable at the time the car was acquired, and
- the cars are not provided as part of an employee's remuneration package (eg under a salary packaging arrangement), and employees cannot elect to receive additional remuneration in lieu of the use of the cars.

If an employer meets the above criteria, it can apply *an average business use percentage* to all tool of trade cars held in the fleet in the log book year and the following four years.

In the present case, MediPlus Pty Ltd satisfies all these criteria, as:

- it has a fleet of 25 (which exceeds the 20-car threshold)
- the cars are "tools of trade" as they are car provided to sales representatives and therefore, used extensively in the business
- the employees are required to maintain a log book in the log book year
- it holds log books for 80% of the cars in the log book year (ie 20 out of 25 cars); which exceeds the 75% threshold
- it chooses the make and model of car to be used, rather than the employee
- each car in the fleet had a GST-inclusive value of $35,000 (which is less than the luxury car limit relevant for the 2015/16 income year of $63,184), and

- it would be reasonable to conclude that the cars are not provided as part of an employee's remuneration package and employees cannot elect to receive additional remuneration in lieu of the use of the cars.

As the company is eligible, it can calculate the average business use percentage by:

- gathering all log books kept for each car in the fleet
- determining which of those log books are valid
- confirming that it has valid log books for at least 75% of the cars in the fleet, and
- calculating the average of the business use percentages determined in accordance with each of the valid log books.

In the present case, assuming that this methodology has been adopted, the average business use percentage is calculated as being 80% for the 2016/17 FBT year.

PCG 2016/10 states that this simplified record-keeping approach can be applied for a period of five years in respect of the fleet (including replacement and new cars) provided the fleet remains at 20 cars or more, and subject to there being no material and substantial changes in circumstances. PCG 2016/10 contemplates that a substantial change in such circumstances would be a change in location of the employer's depot that would substantially alter the business use percentage of the fleet.

Further, the simplified approach may also be used as a basis for determining individual fringe benefits amounts for employees, although such amounts would be excluded fringe benefits for these purposes if a fleet car is made available to more than one employee for private purposes in the same FBT year.

AMTG: ¶35-170, ¶35-180, ¶35-210, ¶35-230, ¶35-240, ¶35-690

¶3-060 Exempt benefits

Issue

During the FBT year ending 31 March 2017, Barb's IT Solutions Pty Ltd provided the following benefits to Josephine Lim, an employee of the company:

a) Payment of Josephine's gym membership fees of $50 per month.

b) A bouquet of flowers on her birthday (valued at $80).

c) A laptop computer for Josephine's child (valued at $800).

d) Payment of her airport lounge membership (valued at $500).

e) Reimbursement of the portion of Josephine's mobile phone bill for work-related calls.

Advise Barb's IT Solutions Pty Ltd as to which of the above are not exempt benefits and calculate the FBT payable.

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Solution

(a) Gym membership

The payment on the gym membership fees is an expense payment fringe benefit. The minor benefit exemption under FBTAA s 58P is not available as the benefit is not provided on an irregular or infrequent basis (see *Taxation Ruling* TR 2007/12).

(b) Birthday flowers

The provision of flowers is a property fringe benefit. However, as the benefit is less than $300 in value and provided on an irregular and infrequent basis, ie on Josephine's birthday, the benefit is an exempt minor benefit under s 58P (see TR 2007/12).

(c) Laptop computer

This benefit is a property fringe benefit, as it is provided to an associate of the employee. FBTAA s 58X allows the provision of a portable electronic device acquired after 13 May 2008, such as a laptop computer, to be exempt for FBT purposes provided that it is "primarily for use in the employee's employment" and only one is provided per FBT year. As the laptop is used by Josephine's child, it is not used in her employment and therefore, the benefit is subject to FBT.

(d) Airline membership

FBTAA s 58Y provides that eligible memberships provided or reimbursed by employers are exempt benefits. Airline lounge memberships are "eligible" and therefore exempt.

(e) Reimbursement of mobile phone costs

The reimbursement of work-related phone costs is an expense payment fringe benefit under FBTAA s 20. As the employee would have been entitled to a tax deduction had she incurred the cost herself, the taxable value of the benefit would be reduced to nil under the "otherwise deductible rule" pursuant to FBTAA s 24; provided appropriate documentation and declarations are maintained.

AMTG: ¶35-330, ¶35-360, ¶35-645

¶3-080 Entertainment; minor benefits exemption

Issue

John Maguire is employed by HortiSupplies Ltd (HSL) as a sales representative. During 2016/17, HSL sponsors a corporate golf day once a month for the benefit of its staff and valued customers. John attends each monthly golf day so he can create opportunities for gaining extra business for HSL. HSL pays for John's golf club entry fee, the food and drink John consumes, and his taxi fares between his home and the club. It costs HSL approximately $1,000 each year to send John to the golf days.

Advise HSL whether it is liable for FBT in respect of the costs of John attending the golf days and calculate any fringe benefits tax liability.

Solution

When HSL pays for John's entry fee to the golf club, the food and drink John consumes while at the club as well as his taxi fares between his home and the club, it is providing a benefit to John. The word "benefit" for FBT purposes includes any right, privilege, service or facility (FBTAA s 136(1)). It includes entertainment by way of food, drink or recreation, or accommodation or travel to do with providing entertainment by way of food, drink or recreation (s 136(1); ITAA97 s 32-10(1)).

The Commissioner considers that attending a golf day is a social event (see the ATO's publication *Fringe benefits tax (FBT) and entertainment for small business*). The purpose of the golf day is considered to be entertainment and paying for John to attend is a benefit in the form of entertainment.

The benefits are "fringe benefits" as defined because HSL provides them to John in respect of his employment (FBTAA s 136(1) and s 148).

The payment of the expenses for the golf days would be an expense payment benefit. They would come within the provisions of FBTAA Div 5. Under s 20, an expense payment benefit arises where the employer makes a payment on behalf of the employee. The taxable value is the amount paid in respect of the expense benefit.

The minor benefits exemption (FBTAA s 58P) is not likely to apply to John's benefits. However, benefits provided with a value of less than $300 that are "infrequent or irregular" may be exempt. However, taken together, the value of the benefits is more than $300 and it could not be said that they are "infrequent or irregular".

While there is an FBT exemption for taxi travel between home and work (FBTAA s 58Z), this does not apply to John's taxi travel to or from the golf day because it does not start or end at his place of work.

As HSL has provided an expense payment fringe benefit to John in respect of his employment and the minor benefits FBT exemption does not apply, HSL will be liable for FBT in respect of the amount it paid for John to attend the corporate golf days.

The taxable value is $1,000. As GST will be payable on the benefit, it is a Type 1 benefit and the grossed up taxable value is:

$1,000 × 2.1463 = $2,146.30 and the FBT = $2,146.30 × 49% = $1,051.68.

AMTG: ¶35-000, ¶35-617, ¶35-645

¶3-100 Loan fringe benefit

Issue

James Mason works for Fincomp Pty Ltd, a finance company. On 1 April 2016 James requested a loan of $100,000 to undertake renovations on his home and build up his share portfolio. James spent $60,000 on the home renovations and the balance on purchasing shares. He holds no shares in the finance company. The loan was offered on commercial terms. This type of loan was available to all other long serving employees with an interest rate of only 3.45%, which is less than that provided to the public.

Calculate the FBT liability for the loan for the 2016/17 FBT year.

Solution

The provision of the loan to James constitutes a benefit by his employer referred to as a loan fringe benefit (FBTAA s 16). The loan would not be exempt (FBTAA s 17) as the finance company is a moneylender that is offering loans to employees that are different to those offered to the public (*Taxation Determination* TD 95/18).

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James Mason is an employee of the finance company and not a shareholder, and the circumstance would not render the loan a dividend under ITAA36 s 109D.

James has used the loan in two ways: 60% for a private purpose to renovate his home and 40% for a taxable purpose to purchase shares (interest is deductible against dividend income).

In relation to the $40,000 spent on shares, the otherwise deductible rule applies (FBTAA s 19). This rule reduces the taxable value of the loan so that none of the interest relating to the share purchase amount is brought to account in calculating the taxable value of the loan benefit, because the interest on the shares purchased for investment would be deductible to James.

The taxable value of the loan is based on the difference between the notional amount of interest (based on the benchmark rate) and the actual amount of interest accrued (FBTAA s 18).

The notional interest rate or benchmark rate for 2016/17 is 5.65% (*Taxation Determination* TD 2016/5).

Therefore, the taxable value of the $100,000 loan is $2,200, calculated as follows:

	$
Notional amount of interest	
Loan amount ($100,000) × notional interest rate (5.65%)	5,650
Less	
Amount of interest accrued	
Loan amount ($100,000) × amount of interest accrued* (3.45%)	3,450
Taxable value	$2,200

*This calculation is based on a fixed rate of interest, as the facts do not refer to any variable rate changes.

The reduced taxable value of the loan (FBTAA s 19) is the taxable value less the notional deduction.

The notional deduction is $880 and is calculated using the formula:

GD – RD

where

GD is the gross deduction, ie the amount allowable for gross loan interest $5,650 × 40% = $2,260,

and

RD is the allowable deduction for interest that accrued on the loan $3,450 × 40% = $1,380

	$
Taxable value	2,200
Less Notional deduction	880
Reduced taxable value	$1,320

The loan is a Type 2 benefit as it is a financial arrangement and GST could not be claimed as an input tax credit. The gross-up factor is 1.9608 with the grossed-up taxable value calculated as follows: $1,320 × 1.9608 = $2,588.

The FBT liability is $2,588 × 49% = $1,268.12

AMTG: ¶35-270, ¶35-290, ¶35-300

¶3-120 Housing fringe benefits

Issue

Jacqueline Suzanne is single with no dependents and leases an apartment in the city of Adelaide. She is employed by a national vegetable processing company. On 1 June 2016 Jacqueline accepted a promotion to a management position with the company and terminated the lease giving four weeks' notice. The promotion involved a three-year secondment to Barmera, a regional town in South Australia starting 1 July 2016. As part of her salary packaging arrangement, the employer leased a modest three-bedroom home for $350 per week for Jacqueline. Under the arrangement, Jacqueline contributes $50 each week to the rent.

Calculate the taxable value of the housing fringe benefit for the 2016/17 FBT year.

In the alternative, assume Jacqueline accepted the promotion as outlined above however, she was married with two children, she owned a house in Adelaide with her husband that was rented to tenants while she and her family lived in Barmera, and she did not make any rental contributions to the house in Barmera. How would this change the taxable value of the housing fringe benefit?

Solution

Scenario 1

Jacqueline is receiving a housing fringe benefit (FBTAA s 25) as she has been granted a "housing right" (FBTAA s 136) by her employer through the leasing of a unit of accommodation, ie the three bedroom house. She is using the accommodation as her usual place of residence, given her three-year stay in Barmera would be habitual (*Miscellaneous Taxation Ruling* MT 2030), and she has abandoned her leased apartment in Adelaide.

The taxable value of a housing fringe benefit depends on whether the accommodation is outside Australia, in a non-remote region in Australia, or a remote region in Australia. Barmera is a small country town in South Australia with a population of approximately 4,000. However, it is not considered a remote region as defined by ITAA36 Sch 2, as it is not located within Zone A or Zone B (*Taxation Ruling* TR 94/27).

The taxable value of the housing fringe benefit for a non-remote region (FBTAA s 26) is the market value of the rental accommodation less any "recipients rent".

In this case, the taxable value of the accommodation from 1 July 2016 to 31 March 2017 would be $11,700, calculated by taking the market value of the rental accommodation for 39 weeks and subtracting Jacqueline's contribution for that period:

	$
$350 per week × 39 weeks	13,650
Less $50 × 39 weeks	1,950
Taxable value	$11,700

Note that the supply of residential premises is input taxed with no GST included. A Type 2 gross-up factor therefore applies in calculating the fringe benefits tax payable.

Scenario 2

It is assumed that Jacqueline would sign the lease as the employee receiving the housing fringe benefit, and would therefore receive the "housing right" — although her family share this benefit.

An important issue to consider is whether the unit of accommodation that has been offered would be a usual place of residence given that Jacqueline and her husband continue to own a house in Adelaide. The fact they have rented their house to tenants would indicate they have abandoned that home as their usual place of residence. This would mean that they no longer have the intention to return to Adelaide in the short-term and that their Adelaide home would no longer qualify as their usual place of residence. The only significant difference therefore from the facts in Scenario 1 is that no contribution to the rent has been paid by Jacqueline. In this second scenario, the taxable value of

the accommodation from 1 July 2016 to 31 March 2017 would be $13,650, ie the market rental value of the accommodation for 39 weeks.

If Jacqueline and her husband did not rent out their Adelaide home and the family returned to live in it on a number of occasions throughout the 2016/17 FBT year, then it is arguable that the family has maintained that home as a usual place of residence. This situation could qualify as an exempt residual fringe benefit under FBTAA s 47(5). For a s 47(5) benefit to apply, the Commissioner would require a declaration by the employee in the approved form on or before the time that the employer lodges an FBT return (*Miscellaneous Taxation Ruling* MT 2021 (withdrawn)) advising on the following three requirements of s 31F(1)(a):

- the address of their usual place of residence
- that their usual place of residence is available for immediate use and enjoyment and so satisfies the requirements of s 31C, and
- the address where they actually reside.

AMTG: ¶35-400, ¶35-420, ¶35-430

¶3-140 Housing fringe benefits; provision of onsite accommodation

Issue

Beryl McMasters works as an onsite duty manager at HiLo Motels. The motel is in the central business district of Perth. Beryl is provided with accommodation in the form of a residential unit behind the motel. Under the terms of her employment agreement, HiLo requires Beryl to reside in the unit so that she is available onsite 24 hours.

Beryl lives in the unit as her private residence; however, the unit is also used for occasional work-related purposes; such as meetings. Outside of the motel, Beryl does not have her own place of residence. The accommodation is provided by HiLo Motels free of charge with no rent being paid by Beryl. This is taken to be part of her compensation in addition to her salary.

As Beryl is required to be on call for her role, HiLo Motels is considering whether the provision of the accommodation would warrant the imposition of any FBT, and if so, the type of fringe benefit provided and whether there are any exemptions available. Advise Hi Lo Motels.

Solution

A fringe benefit will arise where:

- a benefit is provided to an employee, an associate of an employee, or some other person at the direction of an employee or an associate of an employee
- the benefit is provided by the employee's employer, by an associate of the employer, or by a third party under an arrangement with the employer or with an associate of the employer, and

- the benefit is provided in respect of employment of the employee (FBTAA s 136(1), 148(2)).

A "benefit" is broadly defined to include any right, privilege, service or facility. Some benefits are expressly excluded, eg exempt benefits, salary and wages and termination payments.

In considering whether a fringe benefit has been provided, the following applies to HiLo Motels:

- A "benefit" is provided to an employee: The provision of the right to occupy onsite accommodation (ie the residential unit) to Beryl constitutes the provision of a "benefit" for FBT purposes.
- The benefit is provided by an employer, an associate of the employer or a third party: HiLo Motels is Beryl's current employer (s 136(1)). The provision of the right to occupy the onsite accommodation (ie the residential unit) is made to Beryl in that capacity.
- The benefit is provided in respect of the employee's employment: Beryl has been provided with onsite accommodation which allows her to discharge her duty manager responsibilities as defined in her employment contract. Given this connection between the onsite accommodation provided and her duties, it is clear that the accommodation was provided in respect of employment. The connection between the benefit received by Beryl and her employment is material and sufficient, and not merely causal. If it were not for the employment arrangement, Beryl would not have received the onsite accommodation. Therefore, the accommodation has been received in respect of Beryl's employment and would be taken to have been received as part of an arrangement relating to the performance of her work.

Having established that a fringe benefit has been provided, it is then necessary to consider the type of fringe benefit provided. In this case the most likely fringe benefit would be a housing fringe benefit.

A housing fringe benefit arises when an employer grants an employee a "housing right" — a right to occupy or use a unit of accommodation as a usual place of residence — which must be for more than one day (FBTAA s 25 and 149).

Miscellaneous Taxation Ruling MT 2030 discusses the meaning of "usual place of residence".

The main principles from the ruling include:

- There is a general presumption that an employee's usual place of residence is near where the employee is permanently employed.
- To be treated as living away from their usual place of residence, an employee needs to demonstrate that he/she has only moved temporarily to the new location to undertake the relevant work and will return, or there is a legitimate expectation of a return, to live at the employee's former place of residence on the cessation of the work at the new location.

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- Whether an employee is living away from his/her usual place of residence depends on all of the facts of the particular case and is not solely dependent on whether the person is merely living away from his/her "point of origin".

In the present case, Beryl is required to be close to where she is working (that is, to reside onsite and be on-call 24 hours a day, seven days a week). In that sense, she is living in accommodation which is in close proximity to her workplace. This indicates that Beryl's usual place of residence is the accommodation to which she was given the right to occupy.

Further, Beryl's employment is permanent; the employment is not temporary or for a finite duration. She would also arguably spend the majority of her time in the unit of accommodation when she is not working.

Therefore, it is considered that the onsite accommodation provided by HiLo Motels is Beryl's usual place of residence and, as such, all the conditions of a "housing benefit" have been satisfied. The onsite accommodation provided to Beryl will be a treated as a "housing benefit" provided by HiLo Motels, unless otherwise exempted.

An exemption is available under FBTAA s 58ZC in respect of a housing fringe benefit if the accommodation is provided in a remote area. Specifically, in order for the accommodation to be in a remote area, it must not be in, or adjacent to, an "eligible urban area". An "eligible urban area" is an area that is either:

- situated in Zone A or Zone B for income tax purposes and is an urban centre with a 1981 census population of not less than 28,000, or
- not situated in Zone A or Zone B for income tax purposes and is an urban centre with a 1981 census population of not less than 14,000.

The onsite accommodation provided to Beryl is in the Perth central business district and therefore is not provided in a remote area (ie an "eligible urban area"). Therefore, the onsite accommodation benefit provided does not qualify as an exempt remote area housing benefit. There are also no other exemptions for housing benefits under which the benefit could qualify. As a consequence, HiLo Motels would be subject to FBT on the provision of this benefit.

AMTG: ¶35-000, ¶35-060, ¶35-070, ¶35-080, ¶35-380, ¶35-400, ¶35-420

¶3-160 Living-away-from-home allowances

Issue

John Johnson is an architect who worked for a boutique architectural firm in Adelaide where he owns a home. In April 2016, he was offered and accepted a consultant's position with XYZ Pty Ltd, a company designing and assisting in the building of a Melbourne hospital. John was hired to provide on-going advice to the architects, builders and planning board. He received an increase in his annual salary in addition to a weekly allowance of $850 to cover additional food and accommodation costs incurred in his relocation to Melbourne. The relocation was temporary as the design and building project was estimated to take only one year to complete. John is single and is renting an apartment in Melbourne city for $650 per week for the term of the project.

Outline the fringe benefits consequences of this arrangement.

Solution

A benefit paid to employees in the form of an allowance for additional expenses for accommodation and food because the employee is required to live away from their normal residence, is considered a living-away-from-home allowance (LAFHA) fringe benefit (FBTAA s 30). The weekly allowance of $850 paid to John would be such a benefit.

The additional expenses of food and accommodation are not tax deductible to John, as an employee (*Hancox v FC of T* 2013 ATC ¶20-401; *Taxation Determination* TD 93/230).

The taxable value of the benefit where an employee maintains a home in Australia (FBTAA s 31) is reduced by the exempt food and exempt accommodation amounts, which are the expenses incurred by the employee.

Section 31 also requires that:

- the employee must maintain an Australian home (FBTAA s 31C)
- the employee receives a benefit for the first 12 months only (FBTAA s 31D), and
- the employee must make a declaration in the form approved by the Commissioner (FBTAA s 31F).

John maintains a home in Adelaide, and his employment arrangement requires John to live away from his usual place of residence. However, his home must be available for his immediate use while he is in Melbourne. If John rents his home to tenants, he will not be eligible for LAFHA benefits.

As mentioned, the LAFHA receives concessional treatment, as it is reduced by the exempt food and exempt accommodation amounts. The concessional fringe benefit is limited to the first 12 months of stay in Melbourne, after which time the employer will have to pay FBT on the whole allowance. However, this 12-month period need not be continuous and may be paused by the employer, in which case John would be free to return to his Adelaide home, and then resume the duties required by his employer when called upon again. If this happens, the period continues to accrue.

John must sign a declaration in the form approved by the Commissioner prior to the employer lodging their FBT return. John would need to declare:

- his home address
- where he lived in Melbourne, and
- that he is required by his employer to live away from home and that his home is available for immediate use.

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The exempt accommodation and food must be substantiated and the employee is required to either provide relevant documentation before the employer lodges the FBT return or provide a declaration about the expenses and retain the documentation for a period of five years (FBTAA s 31G). However, substantiation is not required if the expenses are reasonable.

In this case, John receives $850 each week as an additional accommodation and food allowance. The accommodation component no longer needs to be considered "reasonable" as it is exempt where the actual accommodation cost is substantiated (s 31), ie through receipts or John's declaration. As John's accommodation costs $650 per week this leaves $200 each week for the additional food.

The Commissioner has set out what he considers reasonable amounts for additional food in *Taxation Determination* TD 2016/4. For example, in the 2016/17 FBT year, the Commissioner considers $242 per week for a single adult in Australian locations to be reasonable.

Therefore, both the additional food and accommodation amounts would be reasonable and not excessive. The amounts would be exempt and therefore the costs incurred by John would reduce the taxable value of the LAFHA fringe benefit to nil.

AMTG: ¶35-460, ¶35-470

¶3-180 Living-away-from-home allowance; fly-in, fly-out

Issue

Pat Newman is to be employed during the 2016/17 FBT year as a fly-in, fly-out worker by a mining company, Emerald Ltd. Pat will be required to work seven days on, six days off in a remote mining town in Queensland. When he is not working, Pat lives in Brisbane with his family.

Emerald Ltd intends to pay Pat an allowance to cover accommodation and meals totalling $700 per week. The total accommodation cost to be incurred by Pat per week will be $500, with the balance to cover Pat's total food costs while he is away at the mine site on duty (ie this allowance will cover food which he would have otherwise consumed at home).

Advise Emerald Ltd on the tax consequences of these arrangements.

Solution

The provision of the accommodation and meal allowance by Emerald Ltd to Pat constitute a living-away-from-home allowance (LAFHA) benefit under FBTAA s 30(1). A LAFHA benefit arises where an employer pays an employee an allowance to compensate for additional expenses or disadvantages suffered because the employee (with or without family) has to live away from home for employment purposes. Pat's employment with Emerald Ltd requires him to live away from usual place of residence (see *Miscellaneous Tax Ruling* MT 2030).

Emerald Ltd is subject to FBT on the provision of the benefit. Provided that certain general conditions are satisfied, the taxable value of the LAFHA benefit is calculated as amount of the fringe benefit reduced by any exempt accommodation and any exempt food components (FBTAA s 31).

Note however, the special requirements that must be satisfied when calculating the taxable value for employers who provide a LAFHA benefit to fly-in fly-out or drive-in drive-out workers (FBTAA s 31A). Under s 31A, the requirements which Emerald Ltd must satisfy include:

- the requirement that Pat, as an employee, has residential accommodation at or near his usual place of employment
- the fly-in fly-out and drive-in drive out requirement (FBTAA s 31E) — broadly, this requires that:
  - Pat work on a regular and rotational basis, works for a number of days on and off, returns to his normal place of residence (ie Brisbane) and on completion of the days off returns to his usual place of employment on the mine site
  - it is customary for Pat to undertake such duties in his industry
  - it would be unreasonable to expect Pat to travel daily on work days between the mine site and his residence, and
  - it is reasonable to expect that Pat will resume living at his normal place of residence when his duties no longer require him to live away from it.
- the declaration requirement (FBTAA s 31F), ie Pat is required to give Emerald Ltd a specific declaration for fly-in fly-out, drive-in drive-out workers.

On the basis that the above requirements are satisfied, the taxable value, calculated for each week that Pat is away from home on duty, is as follows:

Total allowance		$700
Less:		
Exempt accommodation component^	$500	
Exempt food component*	$158	($658)
Taxable value		$42

^Amount taken to be spent on accommodation. Pat must substantiate all accommodation expenses.

*Amount taken to be spent on food *less* statutory food amount, ie $200 – ($42 – $0) = $158. The statutory food amount is $42 per adult. The food allowance paid to Pat by Emerald Ltd is to cover for his total meal costs while he is working away from home.

In addition, because the food component paid is $200, which is less than the Commissioner's reasonable food amount of $242 per adult (see *Taxation Determination* TD 2016/4), the full amount of the food component is accepted as having been spent. Otherwise, Emerald Ltd would be required to request written evidence from Pat to support his expenditure.

FBT is payable by Emerald Ltd based on the statutory food component — this represents the amount covering the costs of food that Pat would have otherwise consumed if he was not working. The allowance currently covers Pat's *total* food cost which includes the statutory food component. However, the amount of FBT may be minimised if it is agreed between Emerald Ltd and Pat that the food allowance is to cover the *additional* food that Pat consumes while he is working (ie in addition to the statutory amount).

As the LAFHA paid is a fringe benefit, it is non-assessable non-exempt income in the hands of Pat (ITAA36 s 23L) and he is not assessed on the allowance.

As noted, Pat is required to provide a specific declaration to Emerald Ltd in the approved form. The declaration must be given to Emerald Ltd before the lodgment date of the company's FBT return. Pat is also required to substantiate the cost of his accommodation costs with written evidence to be provided to Emerald Ltd.

AMTG: ¶10-060, ¶35-460, ¶35-470, ¶35-645

¶3-200 Farming benefits

Issue

Scenario 1: Joseph Phillips — station manager

On 1 April 2016, Joseph Phillips was hired as a station manager to work on a sheep farm. His employer, Merino Pty Ltd leased a two bedroom house for him in Maitland, NSW which is 40 km from the farm. The market value of the rented house was $300 per week, and Joseph made a weekly contribution of $50 to the rent. Joseph also negotiated that his electricity bill be paid by Merino ($2,000 for the period 1 April 2016 to 31 March 2017). Joseph's previous employer had paid for such costs while he was employed in a remote location and that company had received an FBT concession. As part of Joseph's salary packaging arrangement, Joseph's credit card debt of $15,000 was paid off by Merino.

Scenario 2: Jeremy Pike — shearer

Jeremy Pike is a shearer and spent four weeks in late 2016 working at Merino's farm as he travels a shearing circuit in Australia. He was provided with free food and lodging. The standard of the living quarters was equivalent to three-star accommodation with a market value of $120 per night. On the day that he arrived at the farm, Jeremy was provided with the benefit of using the unregistered jeep to explore the large station property. This vehicle is used by the business on the farm only.

Should FBT be imposed on any of the benefits provided and if so, what would be the taxable value?

Solution

Scenario 1: Joseph Phillips — station manager

Provision of housing to Joseph

The provision of a housing benefit in a remote area is an exempt benefit (FBTAA s 58ZC). However, Maitland NSW is not classified as a remote area for FBT housing fringe benefit purposes. Maitland NSW is an urban centre with more than 60,000 people. Therefore, the provision of accommodation to Joseph in Maitland constitutes a housing fringe benefit (FBTAA s 25). The taxable value of that benefit is the market value of the rental of $300 per week less Joseph's contribution of $50 per week (FBTAA s 26).

Taxable value is 52 weeks × $250 = $13,000 for the FBT year.

Note that GST does not apply to private rentals, and accordingly the Type 2 gross-up factor of 1.9608 is used in calculating the fringe benefits tax payable for the 2016/17 FBT year.

Residential fuel

In the situation where an employee receives a remote area housing benefit and the employer pays for the employee's residential fuel (which is any form of fuel and includes electricity), the expense of the fuel paid by the employer is an expense payment fringe benefit. However, the taxable value is reduced by 50% providing that the arrangement is at arm's length (FBTAA s 59).

In this situation, this is not a remote area and the payment for electricity would therefore be an external expense payment fringe benefit (FBTAA s 23). The taxable value would be the cost of $2,000.

Joseph's credit card payments

The direct payment to discharge Joseph's credit card debt would be an external expense fringe benefit. The expense payment is paid to a third party and such expenditure is external to the employer's business. The taxable value is the amount of the expense paid, whether by reimbursement or paid directly less any of the recipient's contribution (s 23).

Assuming that none of the expenditure was deductible, the taxable value would be $15,000, being the amount of the credit card balance that has been paid off (FBTAA s 24).

Note: GST does not apply to finance expenses, and accordingly the Type 2 gross-up factor of 1.9608 applies.

Scenario 2: Jeremy Pike — shearer

Provision of meals and living quarters for Jeremy

Shearers, because of their itinerant occupation, would be eligible to claim deductions for their accommodation and food (see *Taxation Ruling* MT 2029). Although, Jeremy would be receiving a benefit from living quarters, the accommodation would not constitute a housing fringe benefit (FBTAA s 25).

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This is because being itinerant, the provision of living quarters would not constitute a usual place of residence. The living quarters are a residual benefit (FBTAA s 45). However, the taxable value would be reduced to nil as the otherwise deductible rule could apply (FBTAA s 52).

Similarly, the provision of food could be a board fringe benefit (FBTAA s 35) or alternatively a property fringe benefit (FBTAA s 40). In either case the taxable value would be reduced to nil as the otherwise deductible rule could also apply (FBTAA s 37 and s 44).

Note that meals for primary production employees are exempt benefits (FBTAA s 58ZD) providing the farm is not located in or adjacent to an urban area. Meals for primary production employees do not qualify as meal entertainment fringe benefits (FBTAA s 37AC).

Private use of an unregistered motor vehicle

Jeremy has used an unregistered motor vehicle for a private purpose to explore the farm. The use of an unregistered motor vehicle that does not travel on roads is a residual benefit but it is exempted when used principally for business purposes (FBTAA s 47(6A)). Although Jeremy has used the vehicle for private purposes, in this case no FBT would be imposed due to the small amount of private use.

AMTG: ¶35-330, ¶35-340, ¶35-350, ¶35-360, ¶35-380, ¶35-400, ¶35-420, ¶35-430, ¶35-570, ¶35-580, ¶35-630, ¶35-650

¶3-220 Meal entertainment fringe benefits

Issue

ABC Finance Co leased a corporate box at the Brisbane Cricket Ground for $150,000 during the 2016/17 FBT year. This cost included advertising of $60,000 which entitled the company logo to be displayed on the corporate box at all times during entertainment events including displays on the electronic perimeter ring.

During the year, the company spent $20,000 providing food and drinks to staff and clients using the corporate box during events. Cab charges vouchers totalling $10,000 were issued to staff and clients to attend these events and return home safely. Accommodation and airfares for VIP interstate clients to attend entertainment events totalled $5,000. No contributions to these costs were made by staff or clients.

ABC also maintained a 12-week register and determined that 40% of the value of the meal entertainment was a fringe benefit.

Calculate the taxable value of the meal entertainment fringe benefit. Which concessional method would you recommend that ABC elect under FBTAA Div 9A?

Solution

If no Div 9A election is made, meal entertainment expenses could be classified variously as expense payment fringe benefits, property fringe benefits, residual benefits and could even be a tax-exempt body entertainment benefit. Each of these different methods have different valuation rules, exemptions and reductions, resulting in complexity. However, an employer can elect to treat these costs as meal entertainment fringe benefits. This election provides an administrative advantage given special rules reduce compliance costs.

The provision of the corporate box and meals, cab charges, flights and accommodation are all benefits that have been provided by the employer ABC to their employees and clients during the 2016/17 FBT year.

These benefits may be characterised as meal entertainment fringe benefits under Div 9A because:

- the meals provided are food and drink by way of entertainment (FBTAA s 37AD(a))
- the leasing cost of the corporate box is accommodation in connection with the purpose of providing entertainment by way of the food and drink (s 37AD(b))
- the cab charges are travel in connection with the purpose of providing entertainment by way of the food and drink (s 37AD(b)), and
- the airline flights and accommodation expenses for interstate clients are accommodation or travel in connection with the purpose of providing entertainment by way of food or drink (s 37AD(b)).

Despite the cost of the corporate box including a portion of $60,000 for advertising, a deduction for advertising signs is only partially allowable under s 8-1. The Commissioner accepts that the extent to which advertising is deductible is 5% of the total cost, per *Taxation Determination* TD 92/162. As a result, an amount of $7,500 would be deductible from the corporate box lease of $150,000. The meal entertainment fringe benefit pertaining to the leasing cost is therefore $142,500.

The total cost of the benefit is calculated as follows:

	$
Corporate box leasing cost	142,500
Food and drink costs	20,000
Cab charge costs	10,000
VIP client airfares and accommodation	5,000
Total cost of benefit	$177,500

The concessional methods available for determining the taxable value of a meal entertainment fringe benefit are the 50/50 split method and the 12-week register method.

If ABC elects to use the 50/50 split method (FBTAA s 37BA election), the taxable value is 50% of the cost of the benefit, ie $177,500 × 50% = $88,750.

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If ABC elects to use the 12-week register method (FBTAA s 37CA election), the taxable value is 40% of the cost of the benefit, ie $177,500 × 40% = $71,000.

Therefore, ABC should elect the 12-week register method as it yields a lower taxable value. An added advantage of this method is that the 12-week register can be used for the 2016/17 year, and the following four FBT years (FBTAA s 37CD).

AMTG: ¶16-390, ¶35-617

¶3-240 Entertainment, travel and education benefits

Issue

Healey Chocolates Pty Ltd (Healey Chocolates) is a small family company in Hobart managed by its directors Ben and Sharon Healey, who are also employees. The following events occur during the 2016/17 FBT year.

Sharon is paid an allowance of $20,000 to entertain clients as she travels locally and interstate to promote the company. Healey Chocolates also reimburses her for her $100 frequent flyer program joining fee and $1,000 airport lounge membership fee. Sharon accumulated 300,000 frequent flyer points in her name and she used her points to purchase free overseas tickets in February 2017. Ordinarily, Sharon would have had to pay $8,000 for the same tickets for her family holiday.

Ben, the company's book-keeper attended a CPA conference in Sydney to maintain and update his technical accounting skills and this involved travelling to Sydney and two nights' accommodation. Healey Chocolates paid $1,500 directly to the organisers of the conference and $3,500 directly to the travel agent for the airfare and accommodation.

Justin (Ben and Sharon's son) helped out in the business on weekends and nights at no cost to the company. The family company paid Justin's private school fees of $20,000, directly to the college. Jane their daughter studied in Canberra at ANU. Jane's Higher Education Loan Programme (HELP) debt of $10,000 was reimbursed by Healey Chocolates. Jane assumed no FBT applied as the costs would be fully deductible to her as a self-education expense.

Advise Ben and Sharon on the FBT implications of these events.

Solution

Sharon's entertainment allowance

The entertainment allowance is not a fringe benefit. It is ordinary income and is assessable to Sharon under ITAA97 s 6-5 and s 15-2. Accordingly, the entertainment allowance forms part of Sharon's salary and wages. Salary and wages are specifically excluded from the definition of a fringe benefit (FBTAA s 136).

It is important to distinguish an allowance from a reimbursement, the former is income and the latter can be a fringe benefit (see *Taxation Ruling* TR 92/15).

Sharon's frequent flyer and airport lounge fees

If Sharon pays to join the frequent flyer program and/or the airport lounge membership, she may be able to claim a deduction, given travel would be work-related.

Given that Healey Chocolates reimbursed Sharon for the cost of joining the frequent flyer program, the fee would be an expense payment fringe benefit (FBTAA s 23) that could be reduced to nil by the otherwise deductible rule (FBTAA s 24). Further, it would also qualify as a minor and infrequent benefit and would be exempt given the cost was less than $300 (FBTAA s 58P).

Reimbursement of an airport lounge membership is an external expense payment fringe benefit given that the benefit is provided by a third party that is external to the business of Healey Chocolates. The taxable value is the amount of the expense paid, whether by reimbursement or paid directly less any of the recipient's contribution (s 23). However, airport lounge membership fees are exempt benefits under the FBTAA Div 13 exemptions (FBTAA s 58Y).

Sharon's use of frequent flyer points to purchase airfare tickets

Frequent flyer points can provide a benefit when purchasing gifts and travel (at little or no cost) but in general, such benefits are not ordinary income and not considered income to an employee under s 15-2. Flight rewards are also generally not subject to FBT. This is because the points and resulting benefits arise from a personal contractual relationship between the airline and the recipient and not from an employment relationship, despite the points having accumulated because of work-related travel (see *Taxation Ruling* TR 1999/6). An exception arises, and FBT will apply where the employer and employee have a family relationship and the flight reward is received in connection with the employment. In this case, the employer, Healey Chocolates, and the employee, Sharon, have a family relationship. Sharon's duties require that she undertake business travel, and the points arising from that travel have been converted to a benefit for herself, her husband and children (who are associates).

Alternatively, where there is an "arrangement" (such as in this case where travel points have accrued from the company paying for Sharon's travel) and a reward to an employee or their associate arises from business expenditure, FBT may apply. Under the arrangement, there is a sufficient and material connection between the accrued travel points redemption and Sharon's employment and accordingly FBT would apply.

The benefit of cheap or free reward flights for Sharon's airline travel by redeeming points would be considered a residual fringe benefit (FBTAA s 45). The taxable value would be the amount that Sharon would reasonably be expected to pay for the reward, which according to the facts is $8,000 (FBTAA s 50 and s 51).

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¶7-000 Resident individual; calculating tax liability

Lina Chua arrived in Australia on 1 June 2016 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 is single and took out private health insurance when she arrived in Australia.

During 2016/17, Lina earned the following amounts:

- $120,000 salary — $43,000 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 of $170.

Lina's deductible expenditure during 2016/17 is:

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

Calculate Lina's tax liability for 2016/17.

Solution

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

Income tax = (taxable income × rate) − tax offsets.

The amount of income tax payable is calculated by following five 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.

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:

Taxable income = assessable income − deductions

Individuals

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

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

Lina's employer made $11,400 superannuation guarantee contributions for her during the year ($120,000 × 9.5%). These are not taken into account in calculating her assessable income.

Lina has allowable *deductions* of $11,170 (ie $3,550 + $6,500 + $700 + $120 + $300).

The self-education expenses of $3,800 is reduced by $250 to $3,550 due to the operation of ITAA36 s 82A.

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. It would therefore be included as part of the net capital gain listed in assessable income.

Lina's *taxable income* is $144,264 (ie $155,434 assessable income − $11,170 allowable deductions).

Step 2

Lina's gross tax payable on taxable income of $144,264, using the 2016/17 tax rates for a resident individual, is $36,295.68, calculated as follows:

	$
Tax on $18,200	0
Plus ($37,000 – $18,200) × 19%	3,572.00
Plus ($87,000 – $37,000) × 32.5%	16,250.00
Plus ($144,264 – $87,000) × 37%	21,187.68
	$41,009.68

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 $36,295.68 when the tax offset is subtracted.

Step 5

Lina is liable to Medicare levy of $2,885.28 ($144,264 taxable income × 2%). She is not liable to Medicare levy surcharge because she has private health insurance. She is also not liable to temporary budget repair levy because her taxable income does not exceed $180,000.

Individuals

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Payment of income tax

Lina's net tax payable is $39,180.96 ($36,295.68 gross tax payable + $2,885.28 Medicare levy).

When she lodges her income tax return for 2016/17, credit is given for the $43,000 tax withheld by her employer from her salary during the year. As the tax withheld exceeds her tax liability, she is entitled to a $3,819.04 refund ($43,000 – $39,180.96).

AMTG: ¶2-090, ¶10-040, ¶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 2016/17 comprise the following:

Receipts	$
Salary	92,000
Car expenses reimbursed by the employer (cents per kilometre basis)	3,400
Entertainment allowance from employer	2,000
Employer paid holiday	5,000

Expenses	$
Work-related car expenses (using cents per kilometre rate)	3,200
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 self and family (self: $700, wife: $1,100)	1,800
Medical expenses included an electronic walker for his disabled son	6,700

Jones maintains the following dependants during 2016/17:

- 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 2016/17 tax year.

Based on the above information and assuming Ted Jones resides in Ordinary Zone B, determine his taxable income for 2016/17 tax year and calculate his tax payable including any Medicare levy.

Solution

Ted Jones taxable income 2016/17 tax year

(all legislation references are to ITAA97 unless otherwise stated)

	$	$
Assessable Income		
Salary (s 6-5)	$92,000	
Car reimbursement (s 15-70)	3,400	
Entertainment allowance (s 6-5)	2,000	
		$97,400
Deductions		
Car expenses (s 8-1; 28-25)	3,200	
Interest (s 8-1)	750	
Donations (s 30-15 — designated gift recipient)	250	
		4,200
Taxable income		$93,200
Tax payable on $93,200 at 2016/17 rates		22,116.00
Less DICTO[1]	2,335.00	
Zone rebate[2]	599.20	
Medical expenses rebate[3]	880.20	3,814.40
		$18,301.60
Add Medicare levy (2% × taxable income in 2016/17)		1,864.00
TOTAL TAX PAYABLE		$20,165.60

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 $100,000 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).

DICTO (2016/17): $2,627 – [1/4 × (ATIO of the eligible dependent – $282)]
= $2,627 – [1/4 × ($1,450 – $282)]
= $2,335.00

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(2) *Zone rebate — Ordinary Zone B (s 79A)*

Relevant rebate amount = maximum DICTO available + notional dependent rebate (one student, ie $2,335 + $376 = $2,711).

Ordinary Zone B is $57 + (20% × $2,711) = $599.20

(3) *Medical expenses rebate (s 159P(4))*

The terms "medical expenses", "ineligible medical expenses" and "dependants" are defined in s 159P(4). However, s 159P(1B) indicates that for the 2013/14 to 2018/19 tax years the only medical expenses that qualify for the rebate are payments that:

- relate to an aid for a person with a disability, or
- relate to services rendered by a person as an attendant of a person with a disability, or
- relate to care provided by an approved provider (according to the *Aged Care Act 1997*) of a person who:
  - (i) is approved as a care recipient under that Act, or
  - (ii) is a continuing care recipient within the meaning of that Act.

Consequently, the dental expenses for Ted and his wife do not qualify for the rebate.

For single taxpayers with an adjusted taxable income of $90,000 or less or a family with a combined adjusted taxable income of $180,000 or less (if there is one dependent child, with the threshold increasing by $1,500 for each subsequent child after the first), the medical expenses rebate is calculated as follows:

Medical expenses rebate = [(eligible medical expenses − medical refunds) − $2,299] × 20%

Therefore, the medical expenses rebate in this case is calculated as follows:

[$6,700 − 0 − $2,299] × 20%

= $4,401 × 20%

= $880.20

Ted has adequate private health insurance (hospital cover) and therefore avoids the Medicare levy surcharge.

AMTG: ¶2-090, ¶10-060, ¶15-100, ¶15-190, ¶15-320, ¶15-325

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¶7-040 PAYG instalments; tax offsets

Issue

Victoria Jackson is a self-employed interior decorator who advises households and business in the Sydney region of their furnishing needs. Victoria is aged 55 years, single and not registered for GST.

After lodging her 2015/16 income tax return, Victoria's notional taxable income (adjusted for inflation) for the 2016/17 tax year was $48,000, which included a $2,000 donation and a $500 tax agent's fee. Victoria also paid $1,850 to a private health fund from 1 December 2016 for hospital cover and claimed $250 for TFN amounts withheld from interest.

Calculate Victoria's PAYG instalments for the 2016/17 tax year.

Solution

As an individual with investment or business income, Victoria Jackson will have to pay tax by PAYG instalments. The legislation is found in TAA Sch 1 Pt 2-10. Victoria has lodged her tax return for the 2015/16 tax year and her PAYG for the 2016/17 tax year can now be determined.

Victoria may be an annual payer if the following conditions are satisfied (TAA Sch 1 s 45-140(1)):

- the taxpayer's most recent notional tax notified by the Commissioner is less than $8,000
- the taxpayer is not required to be registered for GST
- the taxpayer is not a partner in a partnership that is registered or required to be registered for GST
- if the taxpayer is a company the company is not a participant in a GST joint venture under GST Act Div 51
- if the taxpayer is a company, it is not part of an instalment group (as defined in s 45-145) or participating in GST joint ventures.

Victoria meets all these conditions, and can consequently pay an annual instalment at the end of the first quarter of the following year. If she has come into the PAYG system for the first time during the income year, she can pay at the end of the first quarter for which an instalment would normally be due. Taxpayers who cease to be eligible to pay PAYG on an annual basis will commence paying PAYG instalments from the first quarter of the following income year.

Pursuant to TAA Sch 1 s 45-325(1), notional tax is the adjusted tax on adjusted taxable income for the base year, reduced by the adjusted tax on adjusted withholding income.

(1) Adjusted taxable income = total assessable income less allowable deductions from the most recent assessment:

	$
Total assessable income	50,500
Less: Donation	2,000
Tax agent's fee	500
ADJUSTED TAXABLE INCOME	$48,000*

**Note*: The interest that was subject to TFN withholding does not count as adjusted withholding income.

It is noted that Victoria is entitled to a tax offset for private health insurance pursuant to ITAA97 s 61-205, subject to Subdiv 61-G conditions being met. These include the requirement that the premium be paid in respect of a "complying health insurance policy", such as one that provides hospital cover and/or ancillary cover, and also that the premium is paid in the same income year that it is claimed as an offset.

The 26.79% private health insurance tax offset is reduced for individuals earning more than $90,000, or families earning more than $180,000. The offset cuts out completely for singles earning more than $140,000 and families earning more than $280,000. An individual's entitlement to the offset is now tested against their income for Medicare levy surcharge purposes.

Therefore Victoria is entitled to a private health insurance tax offset of $289.22 calculated as follows:

$$\$1{,}057 \times \frac{121}{365} \times 26.79\%^{\wedge} = \$93.87$$

$$\$793 \times \frac{91}{365} \times 25.93\% = \$51.26$$

Total $145.13

^A rebate of 26.79% applies as Victoria is aged less than 65 years, single and has an income of less than $90,000 for the period 1 December 2016 to 31 March 2017. The rebate is reduced to 25.93% from 1 April 2017 to 30 June 2017.

Victoria is also entitled to a low income rebate of $280 under ITAA36 s 159H calculated as follows:

	$
Maximum rebate amount	445
Less: reduction in rebate [($48,000 – $37,000) × 0.015]	165
Low income rebate entitlement on assessment	$280

2) Adjusted tax on adjusted taxable income at 2016/17 rates:

	$
Tax payable on $48,000 (2016/17 rates)	7,147
Less: Private health insurance tax offset	145
Low income rebate	280
	6,722
Plus: Medicare levy ($48,000 × 2%)	960
2016/17 NOTIONAL PAYG TAX INSTALMENT	$7,682

AMTG: ¶15-300, ¶15-330, ¶27-120, ¶27-200, ¶27-260

¶7-060 Taxable income; tax offsets

Issue

Ian Jacobs, aged 67 years, is married with children. Ian derived $56,000 in salary, $3,000 in bonuses, $800 in bank interest and $5,400 in fully franked dividends during the 2016/17 income tax year. His deductions, which all relate to earning his salary, totalled $2,342.

Ian's wife Mandy does not work and is in receipt of a disability support pension. She had an adjusted taxable income of $730 (including the pension) for the 2016/17 tax year and was not entitled to, nor claimed any family tax benefits.

Ian had adequate private hospital health insurance cover for the year and the tax paid on Ian's salary totalled $12,167 during the 2016/17 tax year.

Based on the above information, calculate Ian Jacobs's taxable income and tax payable/refund including Medicare levy for the tax year ended 30 June 2017.

Solution

Calculation of Ian's tax liability for 2016/17 (all legislation references are to ITAA97 unless otherwise stated)

Assessable Income	$	$
Salary (s 6-5)	56,000	
Bonuses (s 15-2)	3,000	
Bank interest (s 6-5)	800	
Dividends (ITAA36 s 44)	5,400	
Gross up for franking credit ($5,400 × 30 / 70) (s 207-20)	2,314	
Total income		67,514
Less: Deductions		2,342
TAXABLE INCOME		$65,172
Tax payable on $65,172 (2016/17 tax rates)		12,727.90
Less: Offsets		
Dependant invalid carer tax offset (DICTO)^ (s 61-10)		2,515.00
Low income tax offset (LITO)† (s 159H, 159N)		22.42
Franking credit (s 207-20)		2,314.28
		4,851.70
		7,876.20
Add: Medicare levy ($65,172 × 2%)		1,303.44
		9,179.64
Less: Credit for PAYG withheld from salary		12,167.00
TAX REFUND		$2,987.36

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Individuals

Individuals

^*DICTO calculation*	$
Maximum tax offset available (2016/17)	2,627
Reduced for Mandy's adjusted taxable income for offsets less 1/4 of ($730 – $282) (ignore cents)	112
DICTO	$2,515

†*LITO calculation*	$
Maximum tax offset available	445
Reduction for taxable income [($65,172 – $37,000) × 0.015]	(422.58)
LITO	$22.42

Note: As taxable income is below $180,000 there is no budget repair levy payable.

AMTG: ¶2-090, ¶2-320, ¶4-800, ¶15-100, ¶15-300

¶7-080 Small business income tax offset; trust distributions

Issue

The Kent Family Trust (KFT) carries on a business in the food industry and is a small business entity in relation to its business activities. The discretionary beneficiaries of the KFT include Dominic and Rebecca Kent, and their two children, Sally and Thomas who are both under 18 years of age.

Dominic and Rebecca are employed and jointly own some passive investments. Their taxable income for 2016/17, disregarding any distributions from the KFT, is $130,000 each.

For the 2016/17 income year, KFT's net income is $62,000 comprising of:

	$
Gross trading income	80,000
Deductible business expenses related to trading operations	(22,000)
Franked dividends — $14,000 and $6,000 franking credits	20,000
Net rental income from an investment property	15,000
Net capital gain from the sale of a business asset	3,000
Professional tax adviser fees	(3,000)
Expenses related to managing the share portfolio	(1,000)
Prior year losses	(30,000)
NET INCOME	$62,000

According to the trust deed, the distributable income of the trust is equal to its net income for tax purposes.

Rebecca, as trustee of the KFT, will distribute all of the income of the trust for 2016/17. She is making trust distributions for the first time because the trust was settled in 2014/15 and it was in losses in that year and 2015/16. Advise Rebecca on how to effectively distribute the income of the trust.

Solution

Net small business income

Only an individual taxpayer is eligible to claim the small business income tax offset. A taxpayer's small business income tax offset will be equal to 5% of tax payable on "total net small business income" up to a maximum of $1,000 (ITAA97 s 328-360). The taxpayer's total net small business income is the sum of (s 328-360(1)):

- the "net small business income" they make from their sole trader small business entity (SBE)
- their share of the "net small business income" of an SBE (other than a company) that is included in their assessable income (which would include net small business income that forms part of a distribution from the KFT).

An entity's "net small business income" is defined in ITAA97 s 328-365 as assessable income (with some exceptions) that relates to the entity carrying on a business, less allowable deductions (with some exceptions) that are attributable to that income.

Income included in net small business income

For the KFT, its $80,000 gross trading income is the only item of income that is included in its net small business income. The dividends and rental income are not included as those amounts do not relate to the SBE's business. The legislation specifically excludes the net capital gain from the calculation of KFT's net small business income (s 328-365(1)(a)(i)).

Treatment of deductions

To calculate its net small business income, KFT must reduce its net small business income by the deductions that are attributable to the assessable income. This amount is the $22,000 deductions that are attributable to the derivation of the trading income (s 328-365(1)(b)).

The $1,000 share portfolio expenses are not included as they are not attributable to the trading income. In addition, the tax adviser expenses that are deductible under ITAA97 s 25-5 are specifically excluded (ITAA97 s 328-370).

KFT's net small business income is therefore $58,000, ie trading income *less* attributable deductions ($80,000 – $22,000).

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Distributions to Thomas and Sally

Minors are not eligible for the small business income tax offset unless the income is derived from:

- a small business that they are carrying on themselves (ie as a sole trader), or
- a partnership distribution from a small business entity partnership of which they are a partner (ITAA97 s 328-375).

Accordingly, Thomas and Sally cannot access the offset in relation to small business income that is distributed to them from a family trust that is an SBE. Rebecca, as trustee of the KFT, should distribute $416 to each minor. Any distribution exceeding that amount will be taxed at punitive minors' rates.

Because the minors cannot access the small business income tax offset, it would be advisable to stream $832 of the net capital gain ($416 each) to them.

Note that the low income tax offset is not available in relation to family trust distributions. Any trust distribution from KFT in excess of $416 will be taxed at punitive rates with no reprieve available from the low income tax offset.

Distributions to Dominic and Rebecca

After the distributions to Thomas and Sally, there remains $61,168 of trust income for distribution to Dominic and Rebecca ($2,168 net capital gain and $59,000 other net income).

Distribution to each of Dominic and Rebecca:

- $1,084 net capital gain, and
- $29,500 other net income, including $29,000 small business net income of the trust.

Steps to calculate their entitlement to the offset (s 328-360):

Step 1:

Determine the proportion of basic income tax liability that relates to small business activities:

Total net small business income / Taxable income

= $29,000 / $160,584 (being $130,000 + $1,084 + $29,500)

= 0.18

Step 2:

Calculate the tax payable on total net small business income:

Basic income tax liability on $160,584

= $47,048* × 0.18 = $8,469

*Applying 2016/17 tax rates

Step 3:

Calculate the small business tax offset:

The offset for each taxpayer is calculated as the lesser of 5% of $8,469 (ie $423) and $1,000.

Therefore, Dominic and Rebecca can each claim a tax offset of $423.

AMTG: ¶2-160, ¶6-130, ¶7-210

¶7-100 Primary producers; non-commercial losses

Issue

In April 2015, Jay Mitchell, an accountant from Melbourne, purchased a farm for $320,000. Apart from the farm house he has no other farm assets. Jay uses the farmland to agist some horses for the local pony club. In the 2016/17 income year he earned $10,000 in agistment fees. Jay is also considering running the property as a children's farm on weekends. Jay has a large mortgage over the farm with interest payments in excess of the agistment fees earned.

Jay's farm backs onto Alex and Sydney West's farm and he has agreed to share the $30,000 cost of a fence between the two properties. Building of the fence started on 1 February 2017 and was finished on 28 February 2017. During the time that Jay has owned the farm he has seen very little capital growth. He keeps good records and operates in a business-like manner.

Advise Jay as to whether he can claim an immediate write-off for his share of the cost of the fence between the properties under the primary producers accelerated depreciation regime for the 2016/17 tax year. Can Jay offset any loss from the farm against his accountant's salary?

Solution

Immediate write-off for fence

With effect from 12 May 2015 primary producers may claim an immediate write-off for capital expenditure on fencing assets in the year in which the expenditure is incurred (ITAA97 s 40-515 to 40-575). The deduction applies to capital expenditure incurred on the construction, manufacture, installation or acquisition of a fencing asset if that expenditure was incurred *primarily and principally* for use in a primary production business conducted on land in Australia.

A primary production business is defined in ITAA97 s 995-1 and includes a business of 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). Where a property, or substantial part of property is used solely for agistment, a taxpayer would not be considered to be carrying on a primary production business (*Taxation Ruling* IT 225).

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Accordingly, Jay cannot avail himself of the primary producers accelerated depreciation regime, as agistment is the only activity that he is conducting on his farm. Jay cannot claim the cost of his share of the fence of $15,000 as an immediate write-off in the 2016/17 income year. Jay would need to treat the fence as a depreciating asset under ITAA97 Div 40. The effective life for agricultural fencing is 30 years (*Taxation Ruling* TR 2016/1), so Jay would need to apportion the fence cost of $15,000 over this time period or choose to self-assess the effective life of the asset.

Non-commercial losses

Special measures apply to prevent a loss from a non-commercial business activity carried on by an individual taxpayer being offset against other assessable income in the year in which the loss is incurred (ITAA97 Div 35). Under these measures, a loss cannot be offset against other income in the year in which it arises (ie the loss is quarantined). Instead, the loss may be carried forward and offset against assessable income from the business in the next year that the business is carried on (future year).

A loss from a non-commercial activity can be deducted against other income if the taxpayer's "adjusted taxable income" for the income year is less than $250,000 and one of the four tests outlined below is satisfied for the year. If one of the four tests is not satisfied, such taxpayers may offset a non-commercial loss against other assessable income if the Commissioner's discretion is exercised or an exception applies for the year.

The four tests are as follows:

1. *Assessable income test*: the assessable income (including capital gains) for that year from the activity must be at least $20,000 (s 35-30).

2. *Profits test*: the particular activity must have resulted in taxable profit in at least three out of the last five income years, including the current year (s 35-35).

3. *Real property test*: the total reduced cost bases of real property or interests in real property used on a continuing basis in carrying on the activity (other than privately used dwellings and tenant's fixtures) must be at least $500,000 (s 35-40).

4. *Other assets test*: the total value of other assets (other than motor vehicles) used on a continuing basis in the activity must be at least $100,000 (s 35-45).

Applying these four tests to Jay's circumstances:

i. *Assessable income test*: Jay's income from his agistment activities is $10,000, ie less than $20,000, so this condition is not satisfied.

ii. *Profits test*: Jay has not made a profit from his agistment activities as he incurred mortgage interest expenses greater than the fees and also the fence costs. This condition is not satisfied.

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iii. *Real property test*: Jay's property cost base is less than $500,000 so this condition is not satisfied.

iv. *Other assets test*: Jay does not have any other assets in this category so this condition is not satisfied.

Jay does not satisfy any of the conditions under the non-commercial losses regime and accordingly is not permitted to deduct the loss from the farm against his taxable income from his job as an accountant. These losses are quarantined. Jay would need to satisfy one of the above four tests to allow these losses to be used against his other taxable income.

Alternatively, if Jay's accounting job and income from any other sources drops below $40,000, and he develops his business to meet the definition of a primary production business, he will be permitted to offset the prior year losses from this activity.

AMTG: ¶16-020, ¶18-010, ¶18-090

¶7-120 Tax concessions; personal superannuation contributions

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Issue

Jake Woodward is aged 34 years and works part-time as an employee of a suburban travel agency. He also runs his own business arranging educational tours for small groups of travellers and escorting them on those tours.

During 2016/17, Jake earns $45,000 from employment and $23,000 from his own business. His travel agency employer makes superannuation guarantee contributions of $4,275 (9.5% of his ordinary time earnings) to a complying superannuation fund on behalf of Jake.

Jake also makes a personal contribution of $10,000 to the superannuation fund, and contributes $3,000 on behalf of his wife to her superannuation fund. His wife, also aged 34 years, is a full-time student and has no income for 2016/17.

What tax concessions, if any, are available to Jake for the superannuation contributions he makes on behalf of himself or his wife?

Solution

For 2016/17, individuals who make contributions to a complying superannuation fund may be entitled to any of the following tax concessions for the contributions:

(a) a deduction if the individual satisfies various conditions, including the 10% rule which requires the individual's income from employment-related activities to be less than 10% of their total income for the year

(b) a government co-contribution if the individual makes undeducted personal contributions

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(c) a low income superannuation contribution if 15% tax has been taken out of contributions made for a low income individual, and

(d) a tax offset if the individual makes contributions for a low income spouse.

Deduction for the $10,000 personal contribution

Jake is only entitled to a tax deduction for the $10,000 personal contribution if he satisfies the 10% rule in former ITAA97 s 290-160. This rule means that less than 10% of Jake's total income for the year comes from employment-related activities.

Various amounts are taken into account in calculating an individual's total income for a year and their income from employment-related activities, including: (i) salary, wages, commissions and termination payments, (ii) business income, (iii) the value of fringe benefits provided to them, and (iv) employer superannuation contributions resulting from the individual entering into a salary sacrifice arrangement with their employer.

In 2016/17, Jake's total income is $68,000. The percentage of Jake's total income that comes from employment-related activities is 66% (ie $45,000 / $68,000 × 100 = 66%).

Because 66% is not less than 10%, Jake does not satisfy the 10% rule and he is not eligible for a tax deduction for the $10,000 personal contribution he made.

Government co-contribution for the $10,000 personal contribution

A government co-contribution (up to $500) may be made to match an individual's personal contributions where a deduction has not been claimed for the contributions, and the individual's total income for the year is less than the "higher income threshold" (*Superannuation (Government Co-contribution for Low Income Earners) Act 2003*). For 2016/17, the higher income threshold is $51,021.

Jake's total income of $68,000 for 2016/17 exceeds the $51,021 higher income threshold and he is not therefore entitled to a government co-contribution.

Low income superannuation contribution

Individuals whose adjusted taxable income for a year is below $37,000 may be entitled to a low income superannuation contribution (*Superannuation (Government Co-contribution for Low Income Earners) Act 2003*). The contribution is capped at $500 and is intended to compensate the low income earner for the 15% tax on contributions made on their behalf, usually by an employer.

In calculating an individual's eligibility for the contribution, their adjusted taxable income includes not only ordinary income from employment or carrying on a business, but also the value of fringe benefits provided to them in the year, their total net investment losses and employer superannuation contributions made for them under a salary sacrifice arrangement. Jake's $68,000 adjusted taxable income for 2016/17 exceeds $37,000, and he is not therefore eligible for a low income superannuation contribution.

Tax offset for spouse contributions

For 2016/17, an individual who contributes to a superannuation fund on behalf of a spouse is entitled to a tax offset if the spouse's income is less than $13,800 (ITAA97 s 290-230). The spouse must be aged less than 65 years, or aged less than 70 years and gainfully employed on at least a part-time basis during the year, ie has worked at least 40 hours in a 30-day period.

There is no income or age test for the individual making the spouse contributions.

The maximum offset for 2016/17 is $540, based on 18% of maximum contributions of $3,000. The $540 offset is reduced if the spouse's income for the year exceeds $10,800 and is not available at all if the spouse's income is $13,800 or more (ITAA97 s 290-235).

Jake is entitled to a tax offset of $540 for the contributions he makes for his spouse because she has no income for 2016/17.

AMTG: ¶13-730, ¶13-760, ¶13-770, ¶35-070

¶7-140 Salary packaging; tax effectiveness

Issue

James Brown is an accountant working for a company named Benefits R Us Pty Ltd. James has been interested in the salary packaging options the firm has offered its staff. In particular, James would like to salary package a laptop with a retail cost $4,400 (GST inclusive) so that his children have a computer to use for their school work. Benefits R Us is prepared for James to package the item provided the total remuneration cost (TRC) remains unchanged. His current annual package is $90,000 salary and $8,550 superannuation (9.5%).

Assuming Benefits R Us Pty Ltd is a full tax paying entity that is registered for GST purposes what is the tax effectiveness of James receiving a laptop if provided on a salary sacrifice basis for the FBT year ended 31 March 2017?

Solution

The pre- and post-salary package positions for Benefits R Us are as follows:

Benefits R Us	*Pre-package* $	*Post-package* $
Salary	90,000	82,121
Laptop		4,400
FBT		4,627*
Superannuation	8,550	7,802
GST input tax credit		– 400
TRC	$98,550	$98,550

*Note: FBT on the laptop which is used exclusively for private purposes

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Expense payment fringe benefit (FBTAA s 20)

Taxable value = $4,400 × 2.1463 (Type 1 GST inclusive 2016/17) = $9,443.72 × 49% (FBT rate) = $4,627

The pre- and post-salary package positions for James are as follows:

James Brown	*Pre-package* $	*Post-package* $
Salary	90,000	82,121
Net (tax and Medicare) at 2016/17 rates	22,732	19,879
After tax and Medicare	67,268	62,242
Less: Laptop	(4,400)	0
NET CASH	$62,868	$62,242

Salary packaging results in James being $626 worse off. It is noted that in this case James is on marginal tax rate of 37% and that generally packaging provides an advantage for employees on the top marginal rate of 45% tax as the after tax saving is greater.

AMTG: ¶35-057, ¶35-070, ¶35-330

¶7-160 Salary packaging; company car

Issue

Judy Line is an employee of Tel Co Holdings Pty Ltd earning a gross salary of $100,000. Judy entered into a salary sacrificing arrangement with her employer to salary package a company car. The car, which was used exclusively for private purposes, was purchased on 1 April 2016 and cost $44,000 (including GST) and was financed under a four-year lease. The monthly lease payments are $1,500 ($18,000 per year). The running costs of the car for the first year came to $12,000.

Under the salary sacrifice agreement, Tel Co will pay the lease payments and the running costs of the car on Judy's behalf and also any FBT associated with the provision of the car. These costs are passed on by Tel Co Holdings to Judy and subsequently deducted from her pre-tax gross salary. In addition, the agreement provides that Tel Co Holdings will pass on to Judy any GST input tax credits it receives associated with the transaction — this results in an addition to Judy's salary.

Assuming Tel Co Holdings uses the statutory formula method for calculating car fringe benefits and Judy has maintained adequate private health insurance what is the tax effectiveness of receiving the car for Judy as provided on a salary sacrifice basis for the FBT year ended 31 March 2017?

Solution

The pre- and post-salary package positions for Judy are as follows:

Judy Line	*Pre-package* $	*Post-package* $
Salary	100,000	100,000
Less motor vehicle costs ($18,000 + $12,000)		(30,000)
Less FBT payable[1]		(9,254)
Add input tax credits[2]		5,090
Remaining cash salary	$100,000	$65,836
Net (tax and Medicare) at 2016/17 rates	26,632	14,260
After tax and Medicare	73,368	51,576
After tax lease and running costs	30,000	0
NET CASH	$43,368	$51,576

Packaging results in Judy being $8,208 better off.

Notes:

1. FBT on the car which is used exclusively for private purposes.

Taxable value: (20% × $44,000 − 0) = $8,800 × 2.1463 (Type 1 GST inclusive 2016/17) = $18,887.44

FBT = $18,887.44 × 49%
= $9,254

2. GST input tax credit = car cost $44,000 / 11 = $4,000 + running costs $12,000 / 11 = $1,090 = $5,090.

The lease is a financial supply which is not subject to GST.

AMTG: ¶35-057, ¶35-150, ¶35-180, ¶35-190, ¶42-000

¶7-180 Income averaging scheme applied to sportsperson

Issue

Bradley Goodman is an Australian resident and a professional athlete who competes in cycling events in Australia and Europe. Bradley's taxable professional income derived from competing in cycling events as well as sponsorship, prizes and awards for winning races and commentating on various cycling events for the previous four years was:

- $45,000 in 2012/13
- $25,000 in 2013/14
- $20,000 in 2014/15, and
- $34,000 in 2015/16.

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In the 2016/17 income year Bradley derived $60,000 from his professional cycling activities and spent $8,000 on equipment, clothing, travel and medical procedures (massage and manipulation). During 2016/17 Bradley was also paid $15,000 to train and coach junior cyclists.

Calculate Bradley's tax liability for the 2016/17 income tax year.

Solution

Significant fluctuations can occur to the income of professional sportspersons. To lessen the impact of these fluctuations on marginal tax rates, special tax rates apply if the professional sportsperson's income is above their average income (ITAA97 s 405-1).

Where the professional sportsperson has above-average professional income, the *Income Tax Rates Act 1986* generally sets a special rate so that the amount of income tax the professional sportsperson pays on the top 4/5 of their above-average special professional income is effectively four times what they would pay on the bottom 1/5 of that income at basic rates (ITAA97 s 405-5).

In calculating his income for the 2016/17 income year, Bradley Goodman is entitled to take advantage of the income averaging provisions, contained in ITAA97 Div 405. The steps involved in the calculation are as follows:

Calculation of Bradley Goodman's income tax payable for 2016/17

1. *Division of Bradley Goodman's total assessable income into assessable professional income and other assessable income:*

	$
Assessable professional income (s 405-20)	60,000
Other assessable income	15,000
Total assessable income	$75,000

2. *Division of Bradley Goodman's total taxable income into taxable professional income and other taxable income:*

	$
Assessable professional income	60,000
Less: Deductions attributable to assessable professional income	8,000
Taxable professional income (s 405-45)	$52,000
Other taxable income from training and coaching	$15,000

3. *Bradley Goodman's average taxable professional income*

This is generally a four-year average (s 405-50) calculated by dividing the sum of Bradley's taxable professional income for each of the last four years by four, ie

$124,000 / 4 = $31,000

4. *Division of Bradley Goodman's total taxable income into above-average special professional income and normal taxable income*

Whether Bradley has any above-average special professional income and, if so, the amount is determined according to s 405-15.

Bradley's above-average special professional income is $21,000 calculated as follows:

	$
Taxable professional income	52,000
Less: Average taxable professional income	31,000
	$21,000

Bradley's normal taxable income is $46,000 calculated as follows:

	$
Average taxable professional income	31,000
Taxable income that is not taxable professional income	15,000
	$46,000

5. *Calculate the tax payable on Bradley Goodman's normal taxable income using ordinary individual income tax rates*

At 2016/17 income tax rates the income tax on Bradley's normal taxable income of $46,000 is $6,497.

6. *Calculate the tax payable on Bradley Goodman's normal taxable income plus 1/5 of the sum of the above-average special professional income using ordinary individual income tax rates*

	$
Bradley's normal taxable income	46,000
1/5 of Bradley's above-average special professional income is: 1/5 × $21,000	4,200
	$50,200
TAX PAYABLE	$7,862

7. *Calculate the difference between tax payable on Bradley Goodman's normal taxable income plus 1/5 of the sum of the above-average special professional income and the tax payable on Bradley Goodman's normal taxable income plus 1/5 of the sum of the above-average special professional income (ie Step 6 – Step 5)*

$7,862 – $6,497 = $1,365

8. *Calculate the tax payable on above-average special professional income (ie Step 6 – Step 5 × 5)*

$7,862 – $6,497 = $1,365 × 5 = $6,825

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Individuals