Taxation Law: Invalid Tax Offset Case Study - Preparing A Tax Return For 2018

Income and Expense Information:

Interest received by taxpayer are held as ordinary income under “sec 6-5 ITAA 1997”. Eric reports the receipt of bank interest from the joint term deposit with his wife at ANZ. The interest received by Eric will be taxable as ordinary income under “sec 6-5 ITAA 1997”. “Section 25-5 of the ITAA 1997” allows a taxpayer with the deduction for the certain costs which also includes expenses occurred in managing tax affairs (Woellner et al., 2016). The sum of $400 paid by Eric to a registered tax agent for preparing a tax return for 2018 will be allowed for specific deduction under “sec 25-5 ITAA 1997”.

Part A: Income from Employment:

A taxpayer when receives any receipt from employment or from the provision of providing any general service will be considered as the subject of income tax for the employee or may be held as fringe benefit tax for the employee. A relation or any type of nexus with the receipt arising as a result of taxpayer’s personal service will be held as ordinary income (Barkoczy, 2016). Under the “sec 6 ITAA 1936” nexus is normally established for the common items that relates to personal service such as salary and wages, commissions, bonuses, fees charged for services given or any type of ancillary payments which is regarded as the “incident of employment”. As noted in “Brent v FCT (1971)” nexus is usually not effected by lump-sum or the one-off receipts for the performance of a particular task.

In the current case Eric establishes that he is working with Blue Merlin Pty Ltd and reports the receipt of gross wages that amounted to $7,800. Eric further reports the receipt of shift allowance that amounted to $2,000. With respect to “sec 6 of the ITAA 1936” the gross wages received by Eric will be held as income earned from personal exertion (Sadiq, 2019). The income will be held taxable as ordinary income under the “sec 6-5 ITAA 1997” as ordinary income. Citing the case of “Brent v FCT (1971)” the amount will be treated as having the character of payment in the hands of Eric because it has adequate nexus with the amount and the income earning activity.

As per the “sec 15-2 of the ITAA 1997” allowances received by employee are not considered as FBT. Rather they are held as assessable income for the employee. The shift allowance is a taxable as statutory income for Eric under the “sec 15-2 ITAA 1997”.

Eric’s employer gave him with a car. As per the “division 2 of the FBTAA 1986” a car fringe benefit happens when the car is provided by employer to an employee for their private usage. The car here is given to Eric will be held as car fringe benefit under the “division 2 of the FBTAA 1986” (Robin & Barkoczy, 2020). This is because under “sec 23L ITAA 1936”, a nexus among the employment relation is seen and the benefit given to Eric is a direct benefit provided to the taxpayer. Referring to “FCT v J&G Knowles”, the car holds sufficient nexus with the benefit and employment of Eric and will be held as fringe benefit. While the employer of Eric will be under

obligation of paying a FBT relating to the value of benefit provided.

As per the positive limbs of “sec 8-1 (1), ITAA 1997” deduction is permitted to the taxpayer from their taxable earnings regarding any loss or outgoing till the extent that the outgoing is occurred in producing taxable income or while executing any business activities for earning taxable earnings. As evident Eric reported a work related expenses on telephone and stationary. Under the “sec 8-1 (1)”, a general deduction will be given to Eric as the expenses were occurred by him in deriving assessable income.

Part B: Income from Business:

Gains that happens from carrying the business activities amounts to an ordinary income under the “sec 6-5 ITAA 1997”. Under the “sec 6-5 (4) ITAA 1997”, the point of derivation of income is held noteworthy because it helps in ascertaining when the income will be considered taxable (Taylor et al., 2017). There are namely two methods of valuing receipts, cash and accrual method. Under the cash method taxpayer is only needed to consider what has been received actually. It is usually applied on business that has few employees. While under the accruals method taxpayer is required to consider income all the income which is appropriate to a specific circumstances. It is namely applied on large business practice that has several employees. As noted in “FCT v Carden (1938)” the court stated that cash method most substantially portray the taxpayer’s true income.

During the year Eric reported the cash receipt of $85,000 from the accounts receivable. The receipts constitute an ordinary business gain under the “sec 6-5 ITAA 1997”. Referring to “FCT v Carden (1938)” cash method has been followed in case of Eric to determine the taxability of the receipts.

As per the “section 8-1 ITAA 1997” expenses related to the purchase of trading stock will be considered as allowable deduction for the business. Under the “sec 70-35, ITAA 1997” in order to bring the trading stock to account for tax purpose all the trading stock in hand at the end of the income year and all trading stock on hand at the end of the year are considered in working out the taxable income of the taxpayer (Main, 2019). When it is noticed that the value of opening stock during the start of the year is greater than value of opening stock, under “sec 70-35 (2) ITAA 1997” the excess value is considered as taxable income. While the value of opening stock is more than the closing stock then the excess amount is allowed for deduction under “sec 70-35 (3) ITAA 1997”. In the current situation of Eric to value the opening stock, the amount of closing stock is greater than the closing stock. Hence, in case of Eric, under the “sec 70-35 (3) ITAA 1997” the excess value is considered for allowable deduction.

Eric during the year reports taking some food items from the stock purchase for private consumption with his family that valued $2,500. The value of closing stock amount is a private expenditure and Eric will be defined deduction under the “negative limbs of sec 8-1 (2), ITAA 1997” (Arnold, 2019). Furthermore, closing stock values of $5,000 is not yet received by Eric until 15th July 2019. As cash method is followed the same has been excluded to determine the value of closing stock for tax purpose.

Compensation received for the loss of income under the insurance policies are held as income in nature and taxable as assessable income. As noted in “FCT v DP Smith (1981)”

compensation received by taxpayer for loss of income under the insurance policy is taxable within “sec 25 and 26J of the ITAA 1936” (Bankman et al., 2018). The sum of $7,900 received for the loss of income is income in nature. Referring to in “FCT v DP Smith (1981)” compensation received by Eric for loss of income under the insurance policy is taxable within “sec 25 and 26J of the ITAA 1936”.

As per the “sec 8-1 (2)” no deduction is permitted to taxpayer for loss or outgoing within this section for outgoing that are capital in type or those that are private in nature. The cash drawings made by Eric of $3,000 is private in nature and hence it is not permitted for tax deduction. While “sec 26-5 ITAA 1997” says that no deduction is permitted for penalties imposed for the offence of Australian law or foreign law. Eric is denied deduction for the fines imposed regarding the breach of Australian customer’s regulations.

As per the “sec 40-25 (1)” an entity is allowed to claim deduction for the amount which is equal to decline in value for the income year of the depreciating asset that is held all through the year. While “sec 40-25 (2)” states that deduction is lowered for an asset’s fall in value up to the use for purpose other than taxable purpose (Hord, 2016). Eric holds mobile phone where 60% of the usage is attributable for business purpose. With respect to “sec 40-25 (2)” deduction for decline in value is allowed to Eric up to the taxable use of mobile phone.

Part C: Rental Property:

As stated under the “sec 6-5 ITAA 1997” receipt of rent will be held as taxable ordinary income under the concept of flow, the rent flows from the investment property (Schenk, 2017). Rent is referred as the payment paid by one party in exchange for the use of another party for the agreed amount of time. Eric during the year received a sum of 23,750 as rent. Hence, under “sec 6-5 ITAA 1997”, rent will be held as taxable ordinary income. Apart from this, Eric also received compensation from rental board regarding the tenants that left and did not paid rent. The sum has been included for assessment purpose as taxable ordinary income under “sec 6-5, ITAA 1997”. Eric reports the receipts of advance rent that amount to $3,000. The advance rent is a taxable ordinary income under “sec 6-5 ITAA 1997”.

As per the ATO, if the total borrowing expenditure is greater than $100 then the deduction is spread over five years or the term of loan whichever is less. Eric reports a loan application fees of $825 for 10-year mortgage. The deduction for fees is spread over the term of loan. Initial repairs that are undertaken to remedy the defects which was present while purchasing the property is viewed as capital expenses under “sec 25-10 ITAA 1997”. Similarly, Eric will be denied deduction for paints done outside walls of the house on 10th July as it is an initial repair under “sec 25-10 (3)”. While the rest of the rental expenses occurred by Eric will be permitted as allowable deduction under “sec 8-1 ITAA 1997”.

Dependent tax offset (valid and invalid carer tax offset):

As per the ATO it is explained that an individual is permitted to claim tax offset if they maintain;

1. Their spouse is invalid or cares for an invalid
2. The taxpayer’s spouse’s parent or taxpayer’s spouse that lives in Australia is an invalid or cares for an invalid.

3. The taxpayer’s spouse or their spouse’s invalid child, brother or sister that aged 16 years or older.

A carer should have for their spouse or their spouse’s invalid child, brother or sister that ages 16 years or older and is;

1. Taxpayer’s dependent spouse, or
2. The taxpayer or their spouse’s dependent parent that lives in Australia.

The carer should also receive the carer payment or carer allowance based on the “Social Security Act 1991” for the care they provide for that person or completely engaged in giving care to the person receiving a disability support pension within the “Social Security Act 1991”, a special needs disability support pension within the “Social Security Act 1991” or an invalidity service pension within the “Veterans Entitlement Act 1986”.

As evident in case of Eric, he reports that he is taking care of his wife Linda as she has lost her eye sight in her left eye 9 months ago due to car accident. Eric is completely taking care of his wife Linda from 1st October 2018. Eric further reports that he receives disability pension from the Centre-link amounting to $9,200 for the year 2019 tax year with no tax deductible expenses. With respect to the guidelines of the ATO, it can be stated that Eric is eligible for claiming invalid and invalid carer tax offset for his wife Linda. Eric’s wife Linda in this case receives disability support pension under the “Social Security Act 1991”. In addition to this, the adjusted taxable income for the income year of 2018/19 is not more than $100,000. Therefore, Eric is eligible for claiming invalid and invalid tax offset.

References:

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