Taxation Determination

Income tax: is an exceptional circumstances relief payment paid to a farmer under the *Farm Household Support Act 1992* 'assessable primary production income' under subsection 392-80(2) of the *Income Tax Assessment Act 1997*?

This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*. A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes. If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

Ruling

1. No. An exceptional circumstances relief payment (ECRP) paid to a farmer[1] under the *Farm Household Support Act 1992* (FHSA 1992) is not 'assessable primary production income' under subsection 392-80(2) of the *Income Tax Assessment Act 1997* (ITAA 1997).

2. The income averaging provisions in Division 392 of the ITAA 1997 allow a tax offset (where taxable income exceeds average taxable income) or impose a liability to pay extra tax (where taxable income is less than average taxable income).

3. The amount of the tax offset or extra tax depends on the amount of 'assessable primary production income'.[2] Because this does not include an ECRP, the tax offset or extra tax (as the case may be) may be less than it would have been if it was included.

4. The application of the averaging provisions must be considered even though a taxpayer, whose assessable income includes an ECRP, is entitled to a beneficiary rebate under subsection 160AAA(3) of the *Income Tax Assessment Act 1936* (ITAA 1936).

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[1] A farmer means a person who has a right or interest in the land used for the purposes of a farm enterprise – see subsection 3(2) of the FHSA 1992.

[2] See the formula for the calculation of the averaging adjustment in section 392-75 of the ITAA 1997 and the formula for the averaging component in section 392-90 of the ITAA 1997.

Date of effect

5. This Determination applies to years of income commencing both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the final Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
25 June 2008

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

Explanation

What is an Exceptional Circumstances Relief Payment?

6. An Exceptional Circumstances Relief Payment (ECRP) is paid under the FHSA 1992 to farmers experiencing difficulty in meeting living expenses in exceptional circumstances.[3] Exceptional circumstances are rare and severe events that are outside those a farmer could normally be expected to manage under responsible farm management strategies. Specifically, they are events that occur on average once every 20 to 25 years and affect income for a prolonged period (for example, longer than 12 months). Drought is one example.[4]

7. Under subsection 8A(1) of the FHSA 1992, a farmer qualifies for an ECRP in respect of a period if the farmer:

a. contributes a significant part of their labour and capital to the farm enterprise;[5]

b. derives a significant part of their income from the farm enterprise; and

c. has a current exceptional circumstances certificate.[6]

8. An ECRP is paid by Centrelink on a fortnightly basis. It is paid at the equivalent rate of the Newstart Allowance or, where applicable, the Youth Allowance or the Partner Allowance. As such, it is subject to similar means tests as those allowances.[7]

9. In order to be eligible to receive an ECRP, a farmer also needs to satisfy the requirements in subsection 8A(1) of the FHSA 1992 and the assets test set out in subsection 10(1) of the FHSA 1992, and not be receiving a social security benefit, a social security pension or a service pension.[8]

Income tax treatment of ECRPs

Assessable income

10. Assessable income consists of ordinary income and statutory income. An ECRP is ordinary income. It is regular and expected. It is to be relied on by the farmer to meet living expenses and is paid to the farmer for that purpose. It is therefore assessable income under subsection 6-5(1) of the ITAA 1997.[9]

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[3] See subsection 6(1) of the FHSA 1992. Payments may now also be made under the FHSA 1992 to certain agriculturally dependent businesses but the primary production income issue does not arise in these cases.

[4] *Information Handbook, Exceptional Circumstances, Guide to the policy and assistance measures provided under Exceptional Circumstances Arrangements*, February 2008. The handbook is produced by the Australian Government Department of Agriculture, Fisheries and Forestry in consultation with State and Territory Government agencies.

[5] A farm enterprise means an enterprise carried on within any of the agricultural, horticultural, pastoral, apicultural or aquacultural industries – see subsection 3(2) of the FHSA 1992.

[6] See subsection 8A(2) of the FHSA 1992.

[7] See subsection 24A(1) of the FHSA 1992.

[8] See subsection 12(1) of the FHSA 1992.

[9] See paragraph 34 of Taxation Ruling TR 2006/3 Income tax: government payments to industry to assist entities (including individuals) to continue, commence or cease business.

Beneficiary rebate

11. A taxpayer whose assessable income includes an ECRP is entitled to a rebate under subsection 160AAA(3) of the ITAA 1936.

Supplementary amount of an ECRP

12. An ECRP may be supplemented by additional payments under the *Social Security Act 1991* by way of rental assistance and remote area allowances. Such payments are exempt income under section 53-10 of the ITAA 1997 and therefore not assessable income.

Averaging for primary producers

13. Division 392 of the ITAA 1997 provides for the long term averaging of a primary producer's tax liability. It reduces or increases the income tax liability of a primary producer to even out the effects of fluctuations in their taxable incomes.

14. This is achieved by comparing the tax payable on basic taxable income worked out using current marginal rates of tax with the tax payable on the same income using a comparison rate that is calculated by reference to average income. This difference is used to work out an 'averaging adjustment'. If basic taxable income is more than average income, the averaging adjustment takes the form of a tax offset that reduces tax payable. If basic taxable income is less than average income, the averaging adjustment is made by increasing the tax that is payable.

15. The long term averaging of primary production income is confined to income from primary production and some income from non-primary production activities.[10] It is the amount of taxable primary production income that determines the amount of the averaging adjustment. In other words, the amount of taxable primary production income determines the amount of the tax offset or the liability to pay extra tax.

Assessable primary production income

16. The amount of taxable primary production income is in turn worked out by reference to assessable primary production income which is defined as:

> …the amount of your basic assessable income for the current year that was derived from, or resulted from, your carrying on a primary production business.[11]

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[10] Where the income from non-primary production activities is $5,000 or less, the whole amount is subject to long term averaging. Where the income from non-primary production activities is between $5,000 and $10,000, the amount (if any) that remains after deducting from $5,000 the excess of that income over $5,000 is subject to long term averaging. Where the income from non-primary production activities is $10,000 or more, none of that income is subject to long term averaging.

[11] See subsection 392-80(2) of the ITAA 1997.

17. The ITAA 1997 does not provide guidance on when an amount is derived from or results from a primary production business. However, the Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No. 2) 1978, which first used the words 'assessable primary production income' in the corresponding provision in the ITAA 1936, does provide some guidance on the scope of its meaning and the type of income to be taken into account.[12] In explaining that the amendments were specifically intended to limit the benefits of averaging to income from primary production, it stated on page 3 that the system is:

> …to be varied so as to more strictly confine averaging benefits to income derived from primary production.

18. It further stated on page 30 that:

> … Under the new arrangements, averaging benefits will be confined to:
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> - that part of taxable income that is derived from a business of primary production; plus
> - where taxable income from non-farm (that is, non-primary production) sources is $5,000 or less, the amount of that income; or
> - where the taxable income from non-farm sources is greater than $5,000, the amount (if any) that remains after deducting from $5,000 the excess of that income over $5,000 – the allowance for non-farm income will thus shade out completely when the non-farm income reaches $10,000.

19. 'Assessable primary production income' is used to confine the application of averaging to income from farm sources. The income that arises from farm sources is taken into account for averaging. Conversely, income that does not have a farm source is excluded. That Explanatory Memorandum[13] indicates that the relationship between the income and the primary production business is to be close and direct rather than indirect or remote.

20. An ECRP is paid by the government to provide welfare support to families experiencing financial hardship. This view is supported by the following statement in the Second Reading Speech to the Farm Household Support Amendment (Restart and Exceptional Circumstances) Bill 1997:

> The measures introduced in this Bill will ensure that farm families experiencing financial hardship have equitable access to welfare support.

21. The view is also supported by the following statement at paragraph 3.2 of the revised Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No. 3) Bill 2006:

> Welfare support for drought affected farmers in areas declared to be in exceptional circumstances is mainly provided through exceptional circumstances relief payments and is delivered by Centrelink on behalf of the Department of Agriculture, Fisheries and Forestry.

22. The source of an ECRP is the government. The payment is not intended to replace primary production income. Rather, it is a welfare support payment from the government to assist affected farmers meet the costs of living. An ECRP does not have a farm source.

23. An ECRP is not income that is derived from, or results from, the carrying on of a primary production business. Therefore, it is not assessable primary production income under subsection 392-80(2) of the ITAA 1997.

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[12] The definition of assessable primary production income in subsection 156(1) of the ITAA 1936 differs very slightly from that in the ITAA 1997.
[13] Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No. 2) 1978.

24. Excluding an ECRP from assessable primary production income does not affect whether a tax offset is available or extra tax is payable under the averaging provisions. This is because an ECRP is included in *both* the key components to be compared – basic taxable income and average taxable income. However, having compared these amounts and determined that a person is entitled to a tax offset or is liable to pay extra tax, the fact that an ECRP is not part of assessable primary production income affects the amount of tax offset or extra tax.

Alternative view

25. There is an alternative view that an ECRP is assessable primary production income. The view is that an ECRP derives or results from you carrying on a primary production business because (in most circumstances) it is only because an individual is a primary producer that they will be eligible to receive an ECRP.

26. In light of the purpose of the averaging provisions as discussed above and the overall context of the provisions, we do not consider the alternative view to be the better view of the way the law operates.

27. It should also be noted that, when a farmer's income is falling, the effect of excluding an ECRP from assessable primary production income is that less additional tax is payable than would be the case if the ECRP were included. This is consistent with what would have been intended in circumstances where a taxpayer is falling under necessitous circumstances.

28. While it is true that if incomes are rising, the exclusion of an ECRP from assessable primary production income means that the tax offset is less than it would have been if an ECRP had been included, that outcome is consistent with the likelihood of increased capacity to pay based on increasing income.

Appendix 2 – Examples

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

Example 1 – Farmer moving into exceptional circumstances

29. *A* farmer *has a basic taxable income for each of the five income years up to and including the 2006-07 income year as detailed below. The 2006-07 income year includes an ECRP of $10,943. The ECRP is the only non-primary production income for that income year. This example ignores the effect of the Medicare levy and the entitlement to any tax offsets.*

Basic taxable income

2002-03 income year	*$20,000*
2003-04 income year	*$40,000*
2004-05 income year	*$40,000*
2005-06 income year	*$20,000*
2006-07 income year	*$20,943*
Average Taxable Income	*$28,188*

30. The farmer is liable to pay extra tax for the 2006-07 income year because their basic taxable income for that income year of $20,943 is less than their average taxable income of $28,188 ($140,943÷5).

31. The averaging adjustment (extra tax) is worked out under section 392-75 of the ITAA 1997. It is effectively the difference between the tax payable on the basic taxable income at the comparison rate of tax that is calculated by reference to average income ($2,828.06) and the tax payable on the basic taxable income at the basic tax rate ($2,241.45) multiplied by a fraction. That fraction is the income that is subject to long term averaging (primary production income and some non-primary production income) divided by the basic taxable income.

32. If the ECRP is included in the farmer's assessable primary production income, the extra tax that the farmer is liable to pay for the 2006-07 income year is $586.61 (that is ($2,828.06 – $2,241.45) x $20,943÷$20,943).

33. If the ECRP is not included in the farmer's assessable primary production income, the extra tax that the farmer is liable to pay for the 2006-07 income year is $280.10 (that is ($2,828.06 – $2,241.45) x $10,000[14]*÷$20,943)*

34. The practical effect of excluding the ECRP of $10,943 from the farmer's assessable primary production income is that the extra tax the farmer is liable to pay in this case is less than the extra tax that would have been payable if the ECRP had (in our view incorrectly) been included.

[14] $20,943 less the ECRP of $10,943.

Example 2 – Farmer moving out of exceptional circumstances

35. A farmer has a basic taxable income for each of the five income years up to and including the 2007-08 income year as detailed below. The 2006-07 and 2007-08 income years include an ECRP of $10,943 and $7,000. The ECRP is the only non-primary production income for those income years. This example ignores the effect of the Medicare levy and the entitlement to any tax offsets apart from the averaging tax offset.

Basic taxable income	
2003-04 income year	*$40,000*
2004-05 income year	*$40,000*
2005-06 income year	*$20,000*
2006-07 income year	*$20,943*
2007-08 income year	*$47,000*
Average Taxable Income	*$33,588*

36. The farmer is entitled to a tax offset for the 2007-08 income year because their basic taxable income for that income year of $47,000 is greater than their average taxable income of $33,588 ($167,943÷5).

37. The averaging adjustment (tax offset) is worked out under section 392-75 of the ITAA 1997. It is effectively the difference between the tax payable on the basic taxable income at the basic tax rate ($8,700) and the tax payable on the basic taxable income at the comparison rate of tax that is calculated by reference to average income ($6,543.73) multiplied by a fraction. That fraction is the income that is subject to long term averaging (primary production income and some non-primary production income) divided by the basic taxable income.

38. If the ECRP is included in the farmer's assessable primary production income for the 2007-08 income year, the tax offset that the farmer is entitled to is $2,156.27 (that is ($8,700 – $6,543.73) x $47,000÷$47,000).

39. If the ECRP is not included in the farmer's assessable primary production income for the 2007-08 income year, the tax offset that the farmer is entitled to is $1,972.76 (that is ($8,7000 – $6,543.73) x $43,000[15]÷$47,000).

40. The practical effect of excluding the ECRP of $7,000 from the farmer's assessable primary production income is that the farmer is entitled to a tax offset for the 2007-08 income year which is less than what the offset would have been if the ECRP had (in our view incorrectly) been included).

[15] Note: this figure includes a non-primary production shade-out amount of $3,000 being $10,000 less the taxable non-primary production income being the ECRP of $7,000 – see subsection 392-90(2) of the ITAA 1997. Therefore, the $43,000 is arrived at by adding together the primary production income of $40,000 (that is $47,000 less the ECRP of $7,000) and the non-primary production shade-out amount of $3,000 – see item 3 of the table in subsection 392-90(1) of the ITAA 1997.

References

Previous draft:
TD 2008/D7

Related Rulings/Determinations:
TR 2006/3; TR 2006/10

Subject references:
- income averaging
- primary production income

Legislative references:
- ITAA 1936
- ITAA 1936 156(1)
- ITAA 1936 160AAA(3)
- ITAA 1997
- ITAA 1997 6-5(1)
- ITAA 1997 53-10
- ITAA 1997 Div 392
- ITAA 1997 392-75
- ITAA 1997 392-80(2)
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- ITAA 1997 392-90(1)
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- FHSA 1992
- FHSA 1992 3(2)
- FHSA 1992 6(1)
- FHSA 1992 8A(1)
- FHSA 1992 8A(2)
- FHSA 1992 10(1)
- FHSA 1992 12(1)
- FHSA 1992 24A(1)
- TAA 1953
- Social Security Act 1991

Other references:
- Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No. 2) 1978
- Revised Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No. 3) Bill 2006, Chapter 3
- Second Reading Speech to the Farm Household Support Amendment (Restart and Exceptional Circumstances) Bill 1997
- Information Handbook, Exceptional Circumstances Assistance, Guide to the policy and assistance measures provided under Exceptional Circumstances Arrangements, February 2008 – (produced by the Australian Government Department of Agriculture, Fisheries and Forestry in consultation with State and Territory Government agencies.)

ATO references

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