TR 2015/D1 - Income tax: income tax matters relating to bodies corporate constituted under strata title legislation

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Draft Taxation Ruling

Income tax: income tax matters relating to bodies corporate constituted under strata title legislation

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What this Ruling is about

1. This Ruling explains specific income tax issues that affect bodies corporate constituted under strata title legislation and proprietors of a lot held under that legislation. In particular, it sets out the principles that determine which entity holds property for the purposes of determining the assessability of income and the deductibility of expenses and how the principle of mutuality applies.

Class of entities

2. This Ruling applies to the class of entities that are strata title bodies or proprietors under a strata title scheme.

Terminology

3. The following terminology is used for the purposes of this draft Ruling.

Strata title scheme

4. A strata title scheme is a reference to a scheme registered under and governed by the following legislation:

- *Body Corporate and Community Management Act 1997* (Qld)
- *Strata Schemes Management Act 1996* (NSW)
- *Owners Corporations Act 2006* (Vic)
- *Strata Titles Act 1998* (Tas)
- C*ommunity Titles Act 1996*, or *Strata Titles Act 1988* (SA), read together with *Real Property Act 1886* (SA)
- *Strata Titles Act 1985* (WA)
- *Unit Titles (Management) Act 2011* (ACT)
- *Unit Titles Act* (NT).[1]

5. A strata title scheme, is a legally recognised arrangement whereby a building and the land upon which it is erected is subdivided into lots or lots and common property. The lots have separate title, the transfer of which is not inherently restricted. The plan of strata subdivision defines the boundaries of the lots. Lots are used for residential, commercial, professional or industrial purposes. A common example would be that of a block of residential flats which may also include professional suites and shops.

Strata title body

6. The term 'strata title body' is a reference to a body corporate created on registration of the strata scheme under the relevant State and Territory statutes.[2]

7. The strata title body is constituted by the proprietors but is a separate legal entity with specified powers, authorities, duties and functions. Though these powers, authorities, duties and functions vary under the different State/Territory Acts, generally they 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

[1] These Acts are collectively referred to in this draft Ruling as 'the State and Territory Acts':

[2] *Strata Schemes (Freehold Development) Act 1973 (*NSW*) (*formerly known as *Strata Titles Act 1973* (NSW) and *Strata Titles (Freehold Development) Act 1973* (NSW)), *Subdivision Act 1988* (Vic) (which replaced the *Strata Titles Act 1967* (Vic), *Body Corporate and Community Management Act 1997* (Qld) (which replaced the *Building Units and Group Titles Act 1980* (Qld) except for certain developments as set out in section 326 of the *Building Units and Group Titles Act 1980* (Qld)), *Real Property Act 1886* (SA) read together with either the *Strata Titles Act 1988* (SA) or the *Community Titles Act 1996* (SA), *Strata Titles Act 1985* (WA), *Conveyancing and Law of Property Act 1884* (Tas), *Unit Titles Act 2001* (ACT) (replacing the *Unit Titles Ordinance 1970* (ACT)) and the *Unit Titles Act* (NT).

- the duty and function to control, manage and administer the common property, to maintain properly 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.

8. A strata title body may also be called a 'strata title body corporate', 'body corporate', 'strata corporation', 'owners corporation' and 'community corporation'.

Proprietor's lot

9. A proprietor's lot (also known as a proprietor's unit) refers to a part of a parcel of land shown on a strata scheme which can be disposed of separately.

Proprietor

10. In this draft Ruling, a proprietor is also a reference to an 'owner' or 'member' and refers to a person recorded in the Land Title Register as entitled to an estate in fee simple or leasehold in the lot.

Common property

11. Common property relates to that part of the strata title scheme not comprised in any proprietor's lot and includes both fixtures and fittings intended for common use. Whether property is 'common property' is a question of fact to be determined with reference to the strata title scheme. However, usual examples include stairways, lifts, passages, common gardening areas, common laundries and other facilities intended for common use, as well as the fixtures and fittings comprised in the common property for example, pool equipment and light fittings. Common property may also include floors of an apartment block used as commercial premises (for example, retail shops or office accommodation).

Sinking fund

12. A sinking fund is set up by the strata title body to cover the costs of capital improvements, capital repairs and non-recurrent expenses.

Ruling

Status for taxation purposes

13. A strata title body is a company for income tax purposes.

14. The Commissioner has a discretion to treat a company as a public company for the purposes of subsection 103A(5) of the *Income*

Tax Assessment Act 1936 (ITAA 1936). This discretion will be exercised in circumstances where the strata title body is in substantial compliance with its obligations and responsibilities as set out in the applicable governing legislation.

15. A strata title body will not be taxed as a non-profit company even if it includes non-profit clauses in its by-laws.

The main sources of income

Amounts contributed by proprietors - application of the mutuality principle

16. An amount that is otherwise assessable to the strata title body will not be included in its assessable income under section 6-5 of the *Income Tax Assessment Act* 1997 (ITAA 1997) where the principle of mutuality applies.

17. 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 therefore are not assessable to the strata title body.

18. Whether other receipts from members are mutual receipts depends on the nature of the transaction and must be decided on the facts and circumstances of each dealing by a process of evaluating and weighing a range of factors. Relevant considerations may include:

- The relationship between an amount received by the strata title body and the common fund – that is, whether it is within matters that govern the mutual relationship between members such that it has the requisite link to the common fund.
- The purpose for which the payment is made – that is, whether the payment of an amount by a member to the strata title body is to meet the member's proportion of their mutual liabilities.
- The capacity in which an amount is paid – that is, whether the member's dealing with the strata title body is within their role as a member.

Example 1: penalty amounts received by the strata corporation – non-mutual receipt

19. *A strata title body has by-laws governing the behaviour of residents and the use of common property. A proprietor (*that is, *a member of the strata title body) breaches one of these by-laws. The breach of the by-law cannot be resolved by the strata title body – it must be resolved by a statutory tribunal.*

20. *An application is made to an independent tribunal to decide the matter. The tribunal makes a determination, imposing a pecuniary*

penalty on the proprietor and orders that it be paid to the strata title body. The strata title body receives the penalty amount from the proprietor.

21. *In this case, the principle of mutuality does not apply to the penalty amount received by the strata title body as the dealing goes beyond the mutual arrangement. Therefore it will form part of the strata title bodies assessable income under section 6-5 of the ITAA 1997.*

Example 2: interest payable on late levies – mutual receipt

22. *A strata title body imposes interest on the late payment of levies by a proprietor. The payment of contributions and levies represent the proprietor's share in the mutual liabilities of the strata title body, and are a contribution to the common fund. The imposition of interest is calculated so as to compensate the other proprietors for a measurable detriment suffered by the common fund.*

23. *In this case, the principle of mutuality applies to the interest received by the strata title body and is not assessable income of that strata title body.*

Income derived from the personal property of the strata title body

24. To the extent they are necessary for operation of the strata scheme, the moneys raised by a strata title body through levies on proprietors, in accordance with the relevant strata scheme legislation, is owned by the strata title body. Any interest, dividends or interest income derived by the body corporate from the investment of moneys held in its fund represents assessable income of the body corporate unless specifically exempted by the ITAA 1936 or ITAA 1997.

25. Income derived from the ownership and use of other personal property (for example, moveable goods and chattels) owned by the strata title body is also assessable to the strata title body. An example is rent charged for the use of washing machines, driers and lawnmowers.

Common property

26. To which entity moneys received in respect of the common property are assessed, will depend on whether under the relevant State or Territory strata title legislation:

- the common property is vested in the proprietors
- the common property is vested in the strata title body as agent for the proprietors, or
- the strata title body holds the common property as trustee on behalf of the proprietors.

27. Where the common property is vested in the proprietors or in the strata title body as agent for the proprietors, the income derived

from the use of the property constitutes assessable income of the individual proprietors.

28. Where strata title bodies hold the common property as trustee on behalf of the proprietors, moneys received from the use of the common property are derived in the capacity as trustee and are assessed in accordance with Division 6 of the ITAA 1936.

Access fees

29. Access fees charged by the strata title body for the inspection of records, including the books of account, all insurance policies, the strata role, the strata plan and the minutes of meetings are assessable income of the strata title body except where they are received from a proprietor.

Distributions to members

30. As the principle of mutuality applies to proprietors' contributions, any distributions to proprietors that are a return of surplus contributions are not assessable income.[3]

31. Any distributions to proprietors out of profits derived by the strata title body constitute dividends which are assessable income of the proprietors under subsection 44(1) of the ITAA 1936 and are able to be franked in accordance with Part 3-6 of the ITAA 1997.

The deductibility of expenses

Capital allowances -deduction for the decline in value of depreciating assets

32. The deductibility of the decline in value of depreciating assets depends on the legal ownership of the personal property or common property that is a depreciating asset.

33. The legal ownership of common property (including moveable property) will depend on whether:

- the strata title body holds the common property as trustee for the proprietors, or
- the common property is vested in the proprietors or is being held by the strata title body as an agent for the proprietors.

34. Where the strata title body holds the common property as trustee for the proprietors, it is the holder of a depreciating asset forming part of the common property for the purposes of Division 40 of the ITAA 1997.[4]

35. Where the common property is vested in the proprietors or is being held by the strata title body as an agent for the proprietors, each proprietor

[3] However, if the proprietor has previously claimed a deduction for their contribution, the return of surplus contributions may have other tax implications.
[4] Refer to section 40-40 of the ITAA 1997.

is a holder of such assets for the purposes of Division 40 of the ITAA 1997.[5]

Example 3: capital allowances - holder of common property of depreciating assets where the property is vested in the strata title body corporate as agent for the proprietors

36. *Nelson owns a unit in a residential unit complex on freehold. The unit is rented (or available for rent) on a commercial basis at all times. There are 10 units in the complex which features a swimming pool, tennis court and change rooms as common property. During the income year the strata title body has acquired a number of door closers that are identical in colour size and function. They have been purchased individually.*

37. *Under the State legislation the ownership of common property is vested in the strata title body as agent for the unit holders. Therefore the proprietors are the holders of the depreciating assets that form part of the common property. As the depreciating asset is held by more than one entity, each entity's interest in the underlying asset is treated as if the interest were itself the underlying asset.*

38. *Therefore, for the purposes of Division 40 of the ITAA 1997, Nelson can obtain a deduction for the cost attributable to his interest in the identical depreciating assets.*[6]

Example 4: capital allowances - balancing adjustment event and the cost of common property depreciating assets

39. *Momo acquired a unit in a residential complex prior to 6 October 2001. The unit has been used to produce rental income since its acquisition.*

40. *When the unit was purchased, under the State legislation, the ownership of the common property was held by the strata title body as trustee for the proprietors as tenants in common. This means that depreciating assets forming part of common property were held by the strata title body as trustee for the proprietors, and in that capacity, the strata title body was a holder of the common property.*[7] *The enactment of new legislation results in the common property being held by the strata title body as agent for the proprietors as tenants in common, rather than as trustee. From this time Momo (the unit owner) starts to hold a depreciating asset forming part of the common property of an existing residential unit complex.*[8]

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[5] Refer to section 40-40 of the ITAA 1997.
[6] Whether Nelson is entitled to an immediate deduction will depend on the total cost of the door closers and whether the cost attributable to his interest in the identical depreciating assets held is $300 or less. For example, if the total cost of the door closers is $500, Nelson can obtain an immediate deduction of $50 as the cost attributable to his interest in the identical depreciating assets held is $300 or less.
[7] Refer to section 40-40 of the ITAA 1997.
[8] Refer to section 40-40 of the ITAA 1997.

41. *As a result, a balancing adjustment event occurs for a depreciating asset forming part of the common property of an existing unit complex because the strata title body stops holding the asset.*[9] *In these circumstances, for the strata title body, the termination value of the asset under the balancing adjustment event is nil.*

42. *As the depreciating asset forming part of the common property is held by more than one entity, Momo must work out the cost of the asset that is his interest for the purposes of determining his deduction for the decline in value of the asset. In this case, Momo started to hold the asset as a result of new legislation – Momo did not pay any amount or incur any liability to hold the asset, and it cannot be said that the purchase price that Momo paid for his unit reflects the value of the asset. Consequently, the cost to Momo to hold a depreciating asset forming part of existing common property is nil.*

Note: if Momo acquired the unit after 6 October 2001, it is considered that the purchase price paid to acquire the unit will reflect the value of the asset. As such, Momo would reasonably attribute the purchase price he paid to acquire his unit to work out the cost of the asset for the purposes of determining his deduction for the decline in value of the asset.

Capital works

43. The deductibility of a portion of construction expenditure under Division 43 of the ITAA 1997 on capital works to which a strata scheme applies depends on whether the particular area is used for income earning purposes. To the extent it is, a deduction for the appropriate portion of construction expenditure is available to the entity incurring the expenditure if they own or lease the area.

Example 5: capital works – deduction for common property

44. *Max acquired a unit in a residential complex prior to 6 October 2001. Construction of the complex commenced after 17 July 1985. Max has used the unit for income producing purposes from the date he acquired the property.*

45. *Under the particular strata title scheme, the strata title body becomes the holder of an estate of leasehold in the common property on registration of the units plan and the common property was held by the strata title body as trustee for the proprietors as tenants in common. The enactment of state legislation relating to strata title schemes, with effect from 6 October 2001, resulted in the estate of leasehold in the common property, including existing common property, being held by the strata title body as agent for the proprietors as tenants in common.*

[9] Refer to paragraph 40-295(1)(a) of the ITAA 1997.

46. *In this case, as the strata title body has continuously held the estate of leasehold in the common property either as trustee or agent for the proprietors, the construction expenditure area related to a proprietor's interest in the capital works forming part of the common property will be treated as being continuously leased from the time of completion for the purposes of Division 43 of the ITAA 1997.*

47. *Consequently, from 6 October 2001, Max may treat that part of the capital works forming part of the common property as 'your area'* for the purposes of *Division 43 of the ITAA 1997. Max may also treat so much of the pool of construction expenditure that reasonably relates to their interest in the common property as 'your construction expenditure'.*

48. *A deduction is, therefore, available to the Max in respect of his interest in the common property where the requirements of Division 43 of the ITAA 1997 are otherwise met.*

Apportionment

49. *Expenses related to earning both assessable income (non-mutual) and non-assessable income (mutual) need to be apportioned by using a method that is fair and reasonable.*

Carry forward losses

50. As mutual receipts are not income, they do not form part of 'exempt income' in the context of general domestic current year losses and undeducted prior year losses.

Date of effect

51. With the exception of paragraph 14, when the final Ruling is issued, it is proposed to apply both before and after its date of issue. Paragraph 14 contains a clarification of the circumstances in which the Commissioner will treat a strata title body as a public company. When the final Ruling is issued, paragraph 14 will apply from the date of issue. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
25 March 2015

Appendix 1 – Explanation

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

Status of a strata title body for income tax purposes

A strata title body is treated as a public company

52. For income tax purposes, a strata title body registered under one of the State/Territory Acts falls within the meaning of 'company' as defined in section 995-1 of the ITAA 1997.

53. It has been the practice of the Commissioner to exercise his discretion under subsection 103A(5) of the ITAA 1936 to treat a strata title body as a public company.[10] The exercise of any discretion requires the Commissioner to have regard to all the facts and circumstances of each particular case.

54. It will be appropriate to exercise the discretion to deem a strata title body to be a public company under subsection 103A(5) of the ITAA 1936 where the strata title body is in substantial compliance with its duties and obligations as set out under the relevant governing legislation. This is on the basis that, given the restrictions placed on such bodies in their governing legislation regarding their use of funds, there is little scope or likelihood of Division 7A or section 109 of the ITAA 1936 applying. Further, if Division 7A was to apply, it may lead to unintended consequences regarding the proprietor's use of the common or personal property of the strata title body. Thus, minor breaches, for example of an administrative nature, should not cause the Commissioner to refuse to exercise the discretion.

A strata title body will not be treated as a non-profit company

55. A strata title body will not be taxed as a non-profit company even if it includes non-profit clauses in its by-laws.

56. A non-profit company is defined in subsection 3(1) of the *Income Tax Act 1986* (ITA 1986) and means, among other things, a company that:

(a) is not carried on for the purposes of profit or gain to its individual members; and

(b) is, by the terms of its constituent documents, prohibited from making any distribution, whether in money, property or otherwise, to its members

57. In the context of a strata title body, the prohibition refers to the capacity, measured on an annual basis, of a strata title body to distribute to its members both in the current year and in future years.

[10] See former Income Tax Ruling IT 2505.

58. Even though a strata title body is not carried on for the purposes of profit or gain to its individual members, a non-profit company must also be prohibited from making any distribution to its members.

59. A strata title body fails this second requirement because, under the various State and Territory strata title legislation governing its operation, a strata title body can make distributions to its members in certain circumstances, for example, on winding up. The by-laws of a strata title body are made under, and are subject to the operation of, its governing State or Territory legislation. Consequently, a by-law to prohibit any distribution to members cannot be created to override or limit the ability of a strata title body to distribute to members in the circumstances permitted by the legislation. The practical effect of the State and Territory legislation is to 'set at nought' any conflicting by-law (see *Nadir Pty. Ltd. v FC of T* (1973) 129 CLR 595; 73 ATC 4074; (1973) 3 ATR 655 at CLR 603; ATC 4079; ATR 660).

60. As bodies corporate are able to make distributions to proprietors in certain circumstances, for example, on winding up, such entities do not qualify as non-profit companies as defined in subsection 3(1) of the ITA 1986 (*AAT Case 44; AAT Case U57* 87 ATC 370; (1987) 18 ATR 3279).

61. Therefore the income derived by a strata title body is taxed at the rate and from the threshold applicable to a company.

Assessable income

The main sources of income

Application of the mutuality principle

62. The principle of mutuality is based on the premise that you cannot derive income from yourself. The principle provides that 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 (see *The Bohemians Club v. Acting Commissioner of Taxation* (1918) 24 CLR 334; [1918] HCA 16).

63. The principle of mutuality requires that contributors to a common fund are entitled to a share in any surplus and any recipients of a surplus must have been contributors to the common fund, (see *Municipal Mutual Insurance Ltd v. Hills* (1930) 16 TC 430 at 448). A distribution of any surplus need not be based on respective contributions, as long as the contributors, as a class, are entitled to the surplus (see *Jones v. South-West Lancashire Coal Owners' Association Ltd* (1927) 1 KB 33; affirmed (1927) 11 TC 790, *The Social Credit Savings & Loans Society Ltd v. FC of T* 71 ATC 4232, and *Sydney Water Board Employees' Credit Union Ltd v. FC of T* 73 ATC 4129).

64. Mutuality will apply provided that there is 'a reasonable relationship' between what a member contributes and what they may be expected or entitled to receive from the fund (see *Sydney Water Board Employees' Credit Union Ltd v. FC of T* 73 ATC 4129 at 4136).

65. Mutuality is limited in its application. It does not include 'any contributions to the fund derived from sources other than the contributors' payments, such as interest from the investment of part of the fund, or income from a business activity conducted by the members' *(*see *Revesby Credit Union Co-operative Ltd v. Federal Commissioner of Taxation* (1965) 112 CLR 564 at 574).

66. Each transaction needs to be examined to determine whether a particular dealing is mutual (see *Royal Automobile Club of Victoria RACV v. Federal Commissioner of Taxation* 73 ATC 4153; (1974) 4 ATR 567; [1974] VR 651).

67. Whether a particular dealing is mutual will be decided on the facts and circumstances of each case by a process of evaluating and weighing a range of factors for the particular circumstance. Relevant considerations may include:

- The relationship between an amount received by the strata title body and the common fund – the principle of mutuality will apply to an amount received by the strata corporation that is within matters that govern the mutual relationship between members such that it has the requisite link to the common fund, and it will not apply to an amount received by the strata corporation that is beyond matters that govern the mutual relationship between members as it will not have the requisite link to the common fund.
- The purpose for which the payment is made - the principle of mutuality will apply to the payment of an amount by a member to the strata title body to meet the member's proportion of the mutual liabilities (see *Sydney Water Board Employees Credit Union Ltd v. Federal Commissioner of Taxation* (1973) 129 CLR 446; 73 ATC 4129; (1973) 4 ATR 157; and *Federal Commissioner of Taxation v. Australian Music Traders Association* 90 ATC 4536; (1990) 21 ATR 471), and it will not apply to the payment of an amount by a member to the strata title body to discharge their individual legal obligation
- The capacity in which an amount is paid - the principle of mutuality will not apply where the member is dealing with the strata title body as a 'stranger' that is, the payment of the amount by the member is done outside their capacity as a member and therefore puts them in the same position as a non-member (see *Liverpool Corn Trade Association Limited v. Monks (HM Inspector of taxes)* (1926) 2 KB 110 and *Municipal Mutual Insurance Ltd v. Hills (HM Inspector of Taxes)* 16 TC 430).

68. Application of these principles in Example 1 of this Ruling, shows that mutuality will not apply to a penalty amount received by the strata title body because:

- The by-laws of a strata title body that govern the behaviour of residents and the use of common property apply irrespective of membership of the strata title body. Their application is beyond matters that govern the mutual relationship between members and therefore any penalty imposed for a breach of the by-laws does not have the requisite link to the common fund.
- The payment of the pecuniary penalty by a proprietor, to the strata title body is undertaken in discharge of their individual legal obligation. The penalty is a deterrent and is in no sense a pre-estimate of the amount required to meet the proprietor's proportion of the mutual liabilities.
- It is considered that the proprietor is dealing with the strata title body as a 'stranger'. The payment of a pecuniary penalty by the proprietor is done outside their capacity as a proprietor and therefore puts them in the same position as a non-member (for example a tenant).
- It is the tribunal, who is a third party, that makes a determination on whether the penalty applies, the amount of the penalty and who receives it.

69. In contrast, Example 2 shows circumstances where mutuality does apply. In this instance as the payment of contributions and levies represent the proprietor's share in the mutual liabilities of the strata title body they are a contribution to the common fund. The imposition of interest for late payment of levies by the strata title body compensates the other proprietors for a measurable detriment suffered by the common fund and is therefore part of that proprietor's contribution to the common fund.

70. It is considered that the obligation arises as a consequence of being a proprietor and is in a sense part of the estimate of the amount which is required to meet the proprietor's proportion of their mutual liabilities. Such a receipt is a contribution by that proprietor for the common benefit of all the proprietors. As a mutual receipt, it is not assessable income of that strata title body.

71. Having regard to these principles, the Commissioner accepts that the principles of mutuality apply to the following amounts paid by proprietors to the strata title body:

- Proprietors' levy – which is directed to for example, an administrative fund, or a sinking, reserve or special purpose fund.

- Payments for their use of personal property of the strata title body for example, washing machines.[11]
- Fees paid for the collection of rents from the common property.
- Access fees paid for the inspection of records held by the strata title body, including the books of account, insurance policies, the strata roll, the strata plan and the minutes of meetings.[12]

72. Conversely, the principles of mutuality will not apply to the following amounts:

- Payments by non-proprietors to the strata title body for their use of personal property of the strata corporation for example, washing machines.
- Access fees paid by non-proprietors for the inspection of records held by the strata title body, including the books of account, insurance policies, the strata roll, the strata plan and the minutes of meetings.
- Fines imposed by the strata corporation on non-proprietors for breaches of by-laws.
- Interest and dividends from invested funds
- Rental receipts from the leasing of common property set aside for the purposes of carrying on a business of leasing professional suites and shops.

Property of the strata title body

73. A strata title body is able to own and control property, provided the item of property is necessary for the basic purposes of the strata scheme.

74. The main types of property in this context are certain funds and chattels.

Funds

75. The strata title body is empowered by the State/Territory Acts to levy the proprietors in proportion to their lot entitlements to enable it to carry out its various duties and functions. The moneys so raised are the personal property of the strata title body. Within a short time of its creation the strata title body must establish one or more funds, depending on the relevant legislation, into which these levies must be paid.

[11] This is the case even though some proprietors may choose to use the goods and chattels of the strata title body and others may not: see *Royal Automobile Club Victoria v. FC of T* (1973) 4 ATR 567; 73 ATC 4153.

[12] This is the case even though some proprietors may choose to use the goods and chattels of the strata title body and others may not: see *Royal Automobile Club Victoria v. FC of T* (1973) 4 ATR 567; 73 ATC 4153.

76. The establishment of funds will depend on the legislative requirements of each strata scheme. For example, under current legislation:

- Queensland[13] and New South Wales[14] legislation requires the establishment of an administrative fund for the payment of the day to day expenses of administration, general maintenance and repair of the common property, and a sinking fund for the payment of non-routine expenses such as the painting or replacement of common property.
- The Australian Capital Territory[15] legislation requires the establishment of an administrative fund and a sinking fund depending on the number of units. Where there are less than 3 units, it requires the establishment of an administrative fund for the payment of day to day expenses of maintenance of the common property and any other property held by the strata title body, insurance premiums and recurrent expenses, and authorises the establishment of special funds for particular purposes. Where there are 4 or more units, it also requires the establishment of a sinking fund for anticipated expenditure that relates to the acquisition of new property, or is necessary for the renewal or replacement of any property (including common property) that the strata title body holds.
- The Northern Territory legislation[16] does not provide for any particular fund – it only prescribes that annual contributions paid by proprietors must be used to fund the administration of the strata title body, maintenance and repairs of common property, insurance premiums and costs associated with the performance of the functions of the strata title body, and authorises the raising of a levy to fund a single item of expenditure and/or a levy to fund a recurring class of expenditure.
- The, Tasmanian[17] and the Victorian[18] legislation requires the establishment of only one fund for the receipt and disbursement of moneys.
- The Western Australian[19] legislation provides for the establishment of both an administrative fund and a reserve fund but it formally requires only the first.

[13] See *Body Corporate and Community Management (Accommodation Module) Regulation 2008* Regulation 137.
[14] See Division 1 of Part 3 to the *Strata Schemes Management Act 1996*.
[15] See sections 73 and 81 of the *Unit Titles (Management) Act 2011.*
[16] See subsection 94(3) of the *Unit Title Scheme Act* and *Unit Title Schemes (Management Modules) Regulations* Schedule 1 Part 5 Regulations 49 to 51
[17] See section 82 of the *Strata Titles Act 1998.*
[18] See Division 4 of Part 3 to the *Owners Corporations Act 2006*.

- In South Australia the *Strata Title Act 1988*[20] provides for one or more funds but does not require the establishment of any particular fund. The *Community Titles Act 1996*[21]requires the establishment of both an administrative fund and a reserve fund.

77. In addition, the strata title body may be empowered by the different State/Territory Acts to levy the proprietors for contributions other than those referred to above, for example, to meet a compensation payment arising out of a negligence suit. These levies are rarely encountered but may necessitate the establishment of other special purpose funds.

78. Proceeds from the sale of, or rentals from, any strata title body's personal property, fees from granting access to books or records of the strata title body, recoveries from insurance claims and interest on moneys invested are deposited in the relevant funds. The State/Territory Acts specify the manner in which these moneys must be invested as well as specifying that any investment income so received forms part of the fund to which the investment belongs. The moneys in each of these funds whether it be the administrative, sinking, reserve or special purpose fund and whether it be from contributions, investments or any other source are the personal property of the strata title body.

Chattels

79. Personal property encompasses movable property or goods and chattels and includes such things as washing machines, driers, lawnmowers, garden hoses and money.

Income from Common property

80. The ownership of the common property varies under different State Acts and Territorial Ordinances:

- in Queensland,[22] Victoria,[23] Western Australia[24] and South Australia[25] the ownership is vested in the proprietors as tenants in common in proportions equal to their lot entitlements
- in New South Wales[26] and the Australian Capital Territory[27] the ownership is vested in the strata title body as agent for the proprietors as tenants in common in proportions equal to their lot entitlements, and

[19] See section 36 of the *Strata Titles Act 1985*
[20] See section 27 of the *Strata Titles Act 1988*
[21] See section 116 of the *Community Titles Act 1996.*
[22] Refer to section 35 of the *Body Corporate and Community Management Act 1997.*
[23] Refer to section 30 of the *Subdivision Act 1988*.
[24] Refer to section 17 of the *Strata Titles Act 1985*.
[25] Refer to section 29 of the *Community Titles Act 1996*.
[26] Refer to section 20 of the *Strata Schemes (Freehold Development) Act 1973*.
[27] Refer to section 19 of the *Unit Titles (Management) Act 2011*.

- in South Australia,[28] Tasmania[29] and the Northern Territory[30] the ownership is vested in the strata title body as trustee for the proprietors as tenants in common in proportions equal to their lot entitlements.

81. Although the ownership of the common property varies between the States and Territories, the administration, control, and management of that property is vested by all State/Territory Acts in the strata title body in its own right.

82. Whether the strata title body or the proprietor are assessable on moneys received in respect of the common property (for example, fees derived from the letting of shops situated on the ground floor of a block of apartments where the ground floor forms part of the common property) varies according to the relevant State strata title legislation. It will depend on whether:

- the common property is vested in the proprietors
- the common property is vested in the strata title body as agent for the proprietors, or
- the strata title body holds the common property as trustee on behalf of the proprietors.

83. In those States/Territories where the common property is vested in the proprietors[31] or vested in the strata title body as agent for the proprietors,[32] the income derived from the use of the property constitutes assessable income of the individual proprietors. This is considered to be so even in those States/Territories where the strata title legislation prevents a proprietor from ever taking physical receipt (other than on winding-up) of the moneys, and where the moneys are paid directly into one of the strata title body's funds. In these cases, proprietors receive a benefit in that the amount needed to be levied on the proprietors by the strata title body as contributions to the administrative or other fund would be reduced by the rental income applied directly to the fund. To the extent money is applied or dealt with for the benefit of the proprietor subsection 6-10(3) of the ITAA 1997 would apply to include these amounts as assessable income of the proprietors. Expenses attributable to the derivation of the income from the common property, including depreciation, would be allowable to the proprietors in proportion to their lot entitlement and to the extent of the revenue producing use of the individual lots.

[28] Refer to section 10 of the *Strata Titles Act 1988*.
[29] Refer to section 10 of the *Strata Titles Act 1998.*
[30] Refer to section 24 of the *Unit Titles Act.*
[31] For example, Queensland, Victoria, Western Australia under the current schemes and South Australia in relation to schemes governed by the *Community Titles Act 1996*.
[32] For example, New South Wales and ACT under the current scheme.

84. In those States/Territories, where the strata title body holds the common property as trustee on behalf of the proprietors,[33] money received from the use of the common property is derived on behalf of the proprietors as beneficiaries. The treatment of income in these circumstances is governed by Division 6 of the ITAA 1936.

Assessability of income

85. In the discharge of its administrative and management functions, a strata title body will receive contributions from proprietors, derive income from property it owns and incur expenses.

86. The extent to which these receipts represent assessable income of the strata title body and expenses are deductible is set out below.

87. Interest, dividends or other income derived by a strata title body from the investment of moneys held in its funds represents assessable income of the strata title body unless specifically exempted by the Income Tax Assessment Acts.

88. Furthermore, as a strata title body is obliged to make available for inspection to an applicant, whether a proprietor, a mortgagee or their authorised representative, all records held by it, including the books of account, all insurance policies, the strata roll, the strata plan and the minutes of meetings, access fees charged would constitute assessable income except where they are received from a proprietor.[34]

89. Rental fees derived from the use of other personal property, for example, a washing machine except where they are received from a proprietor, or profits on the sale of personal property constitute assessable income of the strata title body to the extent provided generally by the Income Tax Assessment Acts.

Distributions to members

90. Under the principle of mutuality, where proprietors have contributed to any administration, reserve or special purpose fund to meet common expenses, and any surplus contributions are returned to those proprietors in their capacity as contributors, such surpluses are not assessable income. However, any distributions to proprietors out of profits derived by the strata title body constitute dividends which are assessable income of the proprietors under subsection 44(1) of the ITAA 1936.

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[33] For example, Tasmania and the Northern Territory under the current schemes and South Australia in relation to schemes governed by the *Strata Titles Act 1988.*

[34] Refer to discussion on mutuality at paragraphs 62 to 72 of this Ruling.

The deductibility of expenses

General principles

91. A strata body corporation can deduct from its assessable income any loss or outgoing incurred in gaining or producing the assessable income to the extent provided by the Income Tax Assessment Acts, and it is not prevented from being deductible by a provision of the Income Tax Assessment Acts.[35]

92. Expenses incurred by a strata title body that are associated with the discharge of its administrative role are deductible by the strata title body in its return of income to the extent that they are generally allowable under the Income Tax Assessment Acts.

93. Deductions for expenditure incurred are allowed in respect of expenses that relate directly to assessable income, such as dividends or other income derived by the strata title body from the investment of moneys held in its funds, access fees charged in relation to its obligation to make available records for inspection and rental income derived from the use of other personal property, for example, a washing machine, or profits on the sale of personal property.[36] Such expenses may include bank fees, depreciation of personal property and fees for preparation of income tax returns.

94. As mutual receipts are not assessable income of a strata title body, the costs incurred to get mutual receipts are not deductible to the strata title body.

Capital allowances- deduction for the decline in value of depreciating assets

95. The capital allowance provisions in Division 40 of the ITAA 1997 allow the holder of a depreciating asset an annual deduction for the decline in value of the asset.

96. The table in section 40-40 of the ITAA 1997 identifies a holder of a depreciating asset in any particular circumstance. In broad terms, a holder of a depreciating asset is its economic owner. In most cases the economic owner will also be the legal owner.

97. Where a strata title body holds depreciating assets that are personal property, being moveable property or goods and chattels, necessary for the basic purposes of the strata scheme, it is the holder of such assets under section 40-40 of the ITAA 1997.

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[35] Refer to section 8-1 of the ITAA 1997.
[36] To the extent they represent assessable income of the strata title body – refer to the discussion in paragraphs 85 to 89 of this Ruling.

98. The legal ownership of common property (which may include moveable property) varies according to different States and Territories strata titles legislation. In the case where the strata title body holds the common property as trustee for the unit holders (refer to relevant States and Territories) it satisfies the requirements of section 40-40 of the ITAA 1997 and is the holder of a depreciating asset forming part of the common property. Where the common property is vested in the proprietors or is being held by the strata title body as an agent for the proprietor, each proprietor is a holder of such assets under section 40-40 of the ITAA 1997.

99. Subsection 40-35(1) of the ITAA 1997 applies to a depreciating asset that is held by more than one entity. It treats each entity's interest in the underlying asset as if the interest were itself the underlying asset. This means that each proprietor's interest in a depreciating asset that forms part of the common property is treated as if that interest is the depreciating asset. One consequence of this is that the taxpayer must work out the cost of the depreciating asset that is their interest as required by Subdivision 40-C of the ITAA 1997.

Balancing adjustment

100. A holder of a depreciating asset must make a balancing adjustment to their assessable income if a balancing adjustment event occurs for the asset and the asset's decline in value is worked out under Subdivision 40-B of the ITAA 1997.

101. The amount of the balancing adjustment is worked out under section 40-285 of the ITAA 1997 by comparing the asset's termination value with its adjustable value. Section 40-300 of the ITAA 1997 provides that the termination value of a depreciating asset is worked out as at the time when a balancing adjustment event occurs. The termination value is, in certain circumstances, an amount specified in the table in subsection 40-300(2) of the ITAA 1997 or, more generally, the amount taken to have been received under section 40-305 of the ITAA 1997.

102. Where there is no termination value as the strata title body stopped holding a depreciating asset forming part of the common property as a result of new legislation as is the case in Example 4 of this Ruling, the amount taken to have been received for such an asset must, therefore, be worked out under section 40-305 of the ITAA 1997. Because the strata title body did not receive an amount or terminate a liability under the balancing adjustment event there is no amount taken to have been received under items 1 or 2 of the table in subsection 40-305(1) of the ITAA 1997 nor any other item in the table.

103. Furthermore, in the circumstances of Example 4, for the purposes of determining the deduction available for the decline in value, where no amount is paid and no liability is incurred to hold the asset, no items in the tables in subsections 40-180(2) or 40-185(1) of the ITAA 1997 apply, so the cost to hold the depreciating asset forming part of the existing common property is nil.

Capital works

104. Broadly, Division 43 of the ITAA 1997 provides a deduction for certain capital expenditure on income-producing buildings and other capital works, including extensions, alterations or improvements. Amongst other things, it provides a deduction for construction expenditure on capital works (including buildings) used for residential accommodation if the construction of the buildings commenced after 17 July 1985 and the capital works are used to produce assessable income. Construction expenditure does not include expenditure on plant.[37]

105. Under section 43-10 of the ITAA 1997 an amount may be deducted for capital works for an income year if there is a construction expenditure area, a pool of construction expenditure for that area and 'your area' is used in a deductible way (including used to produce assessable income).[38] The deduction is available for 'your construction expenditure' which is that part of the pool of construction expenditure that is attributable to 'your area'. A construction expenditure area is the part of the capital works that, at the time construction expenditure was incurred, was or was to be owned or leased by the person incurring the expenditure.[39]

106. For a lessee (including property owners where land is held as leasehold from the Crown) 'your area' is the part of the construction expenditure area that has been continuously leased from the time of completion by the lessee who incurred the expenditure. If an earlier lessee incurred the expenditure, 'your area' is that part of the construction expenditure area that has been continuously leased from the time of completion by that lessee or successive assignees of the lease.

Apportionment

107. Expenses related to earning both assessable income (non-mutual) and non-assessable income (mutual), for example, where management and audit fees can be attributed to investment income, need to be apportioned by using a method of apportionment that is fair and reasonable and accurately reflects the expenses for the year in question.

108. The following formula is an example of a fair and reasonable basis for apportionment in this context.

[(Non-Mutual Income) / (Total Income)] * (Apportionable Expenditure)

109. For the purposes of the formula, Total Income comprises contributors' levies plus all Non-Mutual Income and Apportionable Expenditure does not include expenses that relate solely to mutual receipts like insurance, rates and taxes, maintenance and upkeep of the grounds and buildings.

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[37] Refer to paragraph 43-70(2)(e) of the ITAA 1997.
[38] Refer to section 43-140 of the ITAA 1997.
[39] Refer to section 43-75 of the ITAA 1997.

Carry forward losses

110. Subsection 6-20 of the ITAA 1997 defines 'exempt income' as income which is exempt from income tax and includes income which is not assessable income. The principle of mutuality recognises that one cannot make a profit out of oneself and that income can only be derived from sources outside of oneself. A mutual receipt cannot be treated as income.

111. Consequently, mutual receipts do not form part of 'exempt income' in the context of general domestic current year losses and undeducted prior year losses.

Taxation obligations- lodgment of return

112. A strata title body must lodge an income tax return for a year of income if required by the Commissioner.[40]

113. As a strata title body is a company for income tax purposes, generally, it is required to lodge an income tax return for any year of income in which it has derived assessable income or when requested by the Commissioner.

114. The assessable income of a strata title body is income derived from non-mutual sources, such as interest and dividends from invested funds and fees from non-proprietors for access to books etcetera. Assessable income does not include mutual receipts, such as proprietors' levies or contributions towards administrative and sinking funds.

115. Generally, where the only income derived by a strata title body is mutual in nature, that is, consists solely of proprietors' levies or contributions, there is no assessable income, so the strata title body is not required to lodge a return. In cases where income is derived from non-mutual sources, that is, interest and dividends from invested funds, fees from non-proprietors for access to books etcetera; a return is usually required to be furnished.[41]

Previous Rulings

116. Taxation Ruling IT 2505 and Taxation Determinations TD 92/181, TD 96/22, TD 93/73 and TD 93/7 are withdrawn on and from the issue date of this draft Ruling. To the extent that the

[40] Under section 161 of the ITAA 1936, the Commissioner determines who is required to lodge a return for a year of income. This determination is exercised by a Legislative Instrument published annually.

[41] See the *Strata title body corporate tax return and instructions 2014* (NAT 4125-6.2014) for instructions on how to complete the tax return. A body corporate should use a Company Form C. In those States where bodies corporate hold the common property as trustees, any income generated by the common property should be returned by using a Trust Form T. For the other States, income received from the use of common property should be included in the individual returns of the proprietors.

Commissioner's views in those Rulings still apply, they have been incorporated in this Ruling.

Appendix 2 – Your comments

117. You are invited to comment on this draft Ruling. Please forward your comments to the contact officer by the due date.

118. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	**8 May 2015**
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Appendix 3 – Detailed contents list

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Previous Rulings/Determinations:

IT 2505; TD 92/181; TD 96/22
TD 93/73; TD 93/7

Subject references:

- apportionment
- assessable income
- body corporate
- capital allowances
- capital works
- carry forward losses
- common property
- contributions to bodies corporate by proprietors
- deductions
- mutuality principle
- personal property
- strata scheme

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- Trust Return Form T

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