


TD 2003/D11 - Income tax: Simplified Tax System (STS): does paragraph 328-105(1)(a) of the Income Tax Assessment Act 1997 ('ITAA 1997') apply to an amount received by an STS taxpayer, but not yet derived as ordinary income under the ordinary operation of section 6-5 of the ITAA 1997?

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This document has been finalised by TD 2003/25.

Draft Taxation Determination

Income tax: Simplified Tax System (STS): does paragraph 328-105(1)(a) of the *Income Tax Assessment Act 1997* ('ITAA 1997') apply to an amount received by an STS taxpayer, but not yet derived as ordinary income under the ordinary operation of section 6-5 of the ITAA 1997?

Preamble

*This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the **Taxation Administration Act 1953**. It is only final Taxation Determinations that represent authoritative statements by the Australian Taxation Office.*

1. Yes. Paragraph 328-105(1)(a) of the ITAA 1997 applies to an STS taxpayer so that an amount that has been received, but not yet derived as ordinary income, will be included in their assessable income for the income year in which it is received.

Amounts included in assessable income when received

2. Section 328-105(1) provides that:

‘while you are an *STS taxpayer, the Act applies to you as if:

- a) an amount that would be included in your assessable income under section 6-5 when *derived were derived only when you *received it*; and
- b) an amount you could deduct under section 8-1 (about general deductions), 25-5 (about tax-related expenses) or 25-10 (about repairs) when incurred were incurred only when you *paid* it or it was *paid* for you.’

3. A question has arisen as to how paragraph 328-105(1)(a) applies where an STS taxpayer receives an amount that has not been derived, either wholly or partly, as ordinary income at the time of receipt.

4. The legislative intention of paragraph 328-105(1)(a) is apparent when it is considered in the context of the STS provisions contained in Division 328. The STS provisions were intended to apply to taxpayers using a cash accounting system for ordinary income and deductions, and the STS accounting method is intended to ensure that STS taxpayers account for their income when it is received and account for their allowable deductions when they are paid: see sections 328-5 and 328-100. In this regard, the word

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‘only’ in paragraph 328-105(1)(a) is intended to indicate that an STS taxpayer derives income at the time it is received and at no other time.

5. Paragraph 4.15 of the Explanatory Memorandum for the *New Business Tax System (Simplified Tax System) Act 2001* clearly supports the view that paragraph 328-105(1)(a) is intended to operate so that an amount received by an STS taxpayer before it is derived as ordinary income is included in the taxpayer’s assessable income for the income year in which it is received. That paragraph states:

Another practical effect of paragraph 328-105(1)(a) is that where an STS taxpayer receives a payment that relates to services provided over the next few weeks, but which extend over to the next financial year, the income is taxable in the year that it is received.

6. The alternative construction that, on a literal reading of paragraph 328-105(1)(a), the word ‘only’ means that amounts received are not included in assessable income until they are actually derived does not conform with the legislative intent of the STS provisions, nor the policy that can be discerned from the provisions.

Example 1

7. *Joe conducts a small clothing business and is an STS taxpayer for the 2003-04 income year. Before entering the STS, Joe’s ordinary income from this business was returned on an accruals basis. Joe’s business makes lay-by sales of the type dealt with in Taxation Ruling TR 95/7. On 15 June 2004, one of his customers pays the first instalment in relation to a lay-by sale, which will not be completed until August 2004. Joe includes the amount of the first instalment in his assessable income for the 2000-04 income year, not for the 2004-05 income year when the amount would be derived if he was not an STS taxpayer.*

Example 2

8. *Ellie’s Office Services maintains office equipment for a number of clients who pay a fixed price for services delivered over a two-year period. On 1 November 2003, Ellie enters a contract with Bill’s Bookkeeping to service his photocopier, fax and shredder for the next 24 months, at a fixed cost of \$3,000. Bill pays Ellie the full \$3,000 at the time the contract is signed. If Ellie does not provide the services according to the contract she may have to provide a refund. Ellie is an STS taxpayer in the 2003-04 income year. She will include the full amount of \$3,000 from that contract in her assessable income for the 2003-04 income year, because, as an STS taxpayer, she is deemed to have derived that amount when she receives it, even though she will not be required to provide all of the services under the contract in the year in which she receives the payment.¹*

¹ If Ellie is required to make a refund in a later income year, she will be entitled to claim a deduction in the year in which she actually pays the refund: see paragraph 328-105(1)(b) of the ITAA 1997.

Not all amounts received are income

9. Paragraph 328-105(1)(a) does not operate to include every amount received by an STS taxpayer in their assessable income. Only amounts that the STS taxpayer has received and derived as ordinary income, or has received and will, at some point in time, derive as ordinary income are included in their assessable income for the income year of receipt. For example, if an STS taxpayer receives an amount as a loan, that amount will not be included as their assessable income for the income year the amount is received. This is because the loan is not, and never will be, ordinary income of the STS taxpayer. An example of an amount that may be received as a loan, and which is therefore not an amount that is derived as ordinary income, is an amount borrowed from the AWB (International) Limited, AWB (Australia) Limited, ABB Grain Export Limited or ABB Grain Limited, as considered in Taxation Rulings TR 2001/1 and TR 2001/5.

Date of effect

10. The view in this Determination, about when amounts received before they have been derived as ordinary income become assessable to an STS taxpayer, is different to that taken in the ATO publication, *The Simplified Tax System – A guide for tax agents and small businesses* (Nat 6459-6.2002). The view in this Determination is less favourable for STS taxpayers than the view taken in the publication, as it requires all of an advance payment to be included in their assessable income on receipt, rather than included in their assessable income as the income is derived. Therefore, this Determination will apply only to amounts of income received on or after 1 July 2003.

Your comments

11. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date.

Comments by Date: 30 July 2003

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Commissioner of Taxation18 June 2003

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Related Rulings/Determinations:

TR 95/7; TR 2001/1; TR 2001/5

Subject references:

- Simplified Tax System
- STS taxpayers
- STS accounting method

Legislative references:

- TAA 1953 Part IVAAA
- ITAA 1997 6-5
- ITAA 1997 328-5
- ITAA 1997 328-100
- ITAA 1997 328-105(1)
- ITAA 1997 328-105(1)(a)
- Acts Interpretation Act 1901 15AA

ATO references

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