IT 2505 - Income tax : bodies corporate constituted under strata title legislation

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This document has been Withdrawn.
There is a Withdrawal notice for this document.

Note: This ruling contains references to State and Territory statutes that are no longer current. Care should be exercised to ensure that the principles set out in this ruling are applied in the context of the relevant current State or Territory law.
Note also the following ATO Interpretative Decisions have been published in relation to strata title common property: ATO ID 2003/224; ATO ID 2003/225; ATO ID 2003/226; ATO ID 2003/227; ATO ID 2003/228; ATO ID 2003/229; ATO ID 2003/591; ATO ID 2003/592.

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TAXATION RULING NO. IT 2505

INCOME TAX : BODIES CORPORATE CONSTITUTED UNDER STRATA TITLE LEGISLATION

F.O.I. EMBARGO: May be released

REF N.O. REF: 84/840-9 DATE OF EFFECT: Immediate

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1211429	ASSESSABLE INCOME - BODIES CORPORATE	6(1) 19(1)
	DEPRECIATION - COMMON AND PERSONAL PROPERTY	25(1) 44(1)
	REPAIRS - COMMON AND PERSONAL PROPERTY	51(1) 53
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PREAMBLE This office has examined the income tax treatment of bodies corporate constituted under the strata title legislation of the various States and Territories. A strata 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 (or units as they are commonly called) having separate title, the transfer of which is not inherently restricted. The plan of strata subdivision defines the boundaries of the lots. Units 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 on the ground floor.

2. Strata title schemes in each State or Territory are governed by specific legislation, viz. Strata Titles Act 1973 (NSW) Strata Titles Act 1967 (Victoria), Building Units and Group Titles Act 1980 (Queensland), Real Property Act 1886-1975 (South Australia), Strata Titles Act 1985 (Western Australia), Conveyancing and Law of Property Act 1984 (Tasmania), Unit Titles Ordinance 1970 (A.C.T.) and the Unit Titles Act (N.T.), ("State Acts").

Body Corporate

3. Each of these State Acts has a common feature, namely, the creation, on registration of the strata scheme, of an entity usually known as the body corporate. On registration the

schedule of lot entitlements which allocates a number of lot entitlements to each proprietor's lot in the strata plan is recorded. Lot entitlement defines the share or value of each lot in relation to other lots in the plan. The body corporate 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 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

- 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, to keep records and books of account, to levy proprietors and to deposit these levies in nominated funds.

Common Property

4. Common property is that part of a strata plan not comprised in any proprietor's lot and includes the 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 e.g., pool equipment and light fittings. Cases have been encountered where the entire ground floor of an apartment block formed part of the common property and was used as a shopping arcade and office accommodation. The ownership of the common property varies under different State Acts and Territorial Ordinances:

(i) in Queensland, Victoria, Tasmania and Western Australia the ownership is vested in the proprietors as tenants in common in proportions equal to their lot entitlements;

(ii) in New South Wales the ownership is vested in the body corporate as agent for the proprietors as tenants in common in proportions equal to their lot entitlements; and

(iii) In South Australia, the Northern Territory and the Australian Capital Territory the ownership is vested in the body corporate as trustee for the proprietors as tenants in common in proportions equal to their lot entitlements.

5. 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 Acts in the body corporate in its own right.

Personal Property

6. Personal property is defined as movable property or goods and

chattels and includes such things as washing machines, driers, lawnmowers, garden hoses and money. The body corporate is able to own and control personal property, provided the item of property is necessary for the basic purposes of the strata scheme.

The Funds of the Body Corporate

7. The body corporate is empowered by the State 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 body corporate. Within a short time of its creation the body corporate must establish one or more funds, depending on the relevant legislation, into which these levies must be paid.

8. In Queensland and New South Wales 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 is required by legislation. These States also require the establishment of a sinking fund for the payment of non-routine expenses such as the painting or replacement of common property. The Australian Capital Territory, the Northern Territory, the Tasmanian and the Victorian legislation requires the establishment of only one fund for the receipt and disbursement of moneys. The Western Australian legislation provides for the establishment of both an administrative fund and a reserve fund but it formally requires only the first. The South Australian legislation provides for one or more funds but does not require the establishment of any particular fund.

9. In addition, the body corporate may be empowered by the different State Acts to levy the proprietors for contributions other than those referred to above, e.g., 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.

10. Proceeds from the sale of, or rentals from, any body corporate's personal property, fees from granting access to books or records of the body corporate, recoveries from insurance claims and interest on moneys invested are deposited in the relevant funds. The State 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 body corporate.

RULING

11. For income tax purposes, a body corporate registered under the State Acts is within the definition of a "company" in sub-section 6(1) of the Income Tax Assessment Act. Although bodies corporate do not qualify as public companies as described in sub-section 103A(2), it has been the practice for the Commissioner to exercise his discretion under sub-section 103A(5) to deem bodies corporate under strata titles legislation to be public companies. This practice will continue. Furthermore, as

bodies corporate are able to make distributions to proprietors in certain circumstances, e.g., on winding up, such entities do not qualify as non-profit companies as defined in sub-section 3(1) of the Income Tax Rates Act 1986 (Case U57, 87 ATC 370, AAT Case 44 18 ATR 3279). Therefore the income derived by a body corporate is taxed at the rate and from the threshold applicable to a normal public company.

12. In the discharge of its administrative and management functions, the body corporate may derive assessable income. Interest, dividends or other income derived by the body corporate from the investment of moneys held in its funds represents assessable income of the body corporate unless specifically exempted by the Income Tax Assessment Act. Furthermore, as the body corporate 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. Rental fees derived from the use of other personal property, e.g., a washing machine, or profits on the sale of personal property constitute assessable income of the body corporate to the extent provided generally by the Assessment Act.

13. Similarly, expenses incurred by the body corporate that are associated with the discharge of its administrative role are deductible by the body corporate in its return of income to the extent that they are generally allowable under the Assessment Act. Deductions for expenditure incurred would be allowed in respect of expenses that relate directly to assessable income of the type described in paragraph 12. Such expenses may include bank fees, depreciation of personal property and fees for preparation of income tax returns.

14. Amounts contributed to the body corporate by the respective proprietors by way of levy or contribution for the activities described in paragraphs 7 to 9 above and access fees paid by proprietors in the circumstances outlined in paragraph 12, do not constitute assessable income of the body corporate because of the principle of mutuality. Simply stated, this principle recognises that one cannot make a profit out of oneself and that income can only be derived from sources outside of oneself. In the case of corporate entities, the principle recognises that contributions by proprietors are not in the nature of income because "income consists of moneys derived from sources outside" of the taxpayer, (The Bohemians Club v The Acting Federal Commissioner of Taxation (1918) 24 CLR 334, at page 337), in this case the body corporate. The cardinal requirement for the principle to apply is that there be complete identity between the contributors to the fund and the participants in the surplus (Municipal Mutual Insurance Ltd v Hills (1932) 16 T.C. 430) not in the sense of individual identity but in the sense of identity as a class "so that at any given moment of time the persons who are contributing must be identical with the persons who are entitled to participate" (Faulconbridge v National Employers' Mutual General Insurance Association Ltd (1952) 33 T.C. 103, at page

125). Fees payable to the body corporate by a proprietor for the collection of rents from the common property would also be non-assessable mutual income.

15. As mutual income is not assessable income of the body corporate, amounts expended in relation to activities from which mutual income is derived do not represent tax deductible expenditure to the body corporate.

16. Where expenditure can be apportioned between mutual (non-assessable) and non-mutual (assessable) income, for example, where management and audit fees can be attributed to investment income, the deductible portion of the expenditure is determined in accordance with the formula :

$$\frac{\text{Non-Mutual Income}}{\text{Total Income}} \times \text{Apportionable Expenditure}$$

For the purposes of the formula, Total Income comprises contributors' levies plus all Non-Mutual Income and Apportionable Expenditure does not include insurance, rates and taxes, maintenance and upkeep of the grounds, building or their contents.

17. The assessability of 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. In those States where the common property is vested in the proprietors, viz. Queensland, Victoria, Tasmania, Western Australia, or vested in the body corporate as agent for the proprietors, viz. New South Wales, 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 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 body corporate's funds. In these cases, proprietors receive a benefit in that the amount needed to be levied on the proprietors by the body corporate as contributions to the administrative or other fund would be reduced by the rental income applied directly to the fund. Accordingly, section 19 of the Act 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 (Taxation Ruling No. IT 2398 deals with depreciation of co-owned property).

18. In South Australia, Northern Territory and the Australian Capital Territory, where bodies corporate hold the common property as trustee on behalf of the proprietors, money received from the use of the common property is derived on behalf of the proprietors as beneficiaries. The total assessable income of the body corporate, namely, the rental income from the common property less allowable deductions, including depreciation of the

common property results in a net income figure for the purpose of section 95 and would be included in the assessable income of the proprietors under section 97 in proportion to their lot entitlement. However, where a proprietor is under a legal disability, for example, where he or she is insane or an undischarged bankrupt, that proportion of the net income would be included in the assessable income of the body corporate under section 98.

19. 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 body corporate constitute dividends which are assessable income of the proprietors under subsection 44(1).

20. Under the imputation system of company tax, bodies corporate are subject to Part IIIAA of the Assessment Act in the same way as other companies. Thus, to the extent that a body corporate pays tax or otherwise has franking credits, it is able to impute tax paid at the corporate level to its proprietors by franking the dividends it pays in accordance with Part IIIAA. The normal requirements of that Part will apply and, where overfranking occurs, a body corporate may be liable to pay franking deficit tax. Franking account returns will be required in the normal way for each franking year in which franking credits or franking debits arise, or during which dividends are paid.

21. The practice of granting exemption from lodging returns where all the income derived by the body corporate is mutual in nature, i.e., consists solely of proprietors' levies or contributions, will be continued. In cases where income is derived from non-mutual sources, i.e., interest and dividends from invested funds, fees from non-proprietors for access to books etc; a return is required to be furnished.

22. A body corporate should use a Company Form C. Page one of the return form should be completed in full but the details of income derived and expenses for which a deduction is obtained may be set out on a signed enclosure attached inside the return. Where appropriate the formula outlined in paragraph 16 above should be repeated on the enclosure and duly converted into the amounts applicable for the year concerned ensuring, however, that the individual items comprising 'Apportionable Expenses' are also listed. In those States where bodies corporate hold the common property as trustees, viz. South Australia, Northern Territory and the Australian Capital Territory, 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.

23. The effect of the advice given is illustrated in the example given in the attachment.

COMMISSIONER OF TAXATION

3 November 1988

APPENDIX

ATTACHMENT

	PROPRIETORS AS TENANTS IN COMMON OR AS PRINCIPALS	PROPRIETORS AS BENEFICIARIES	BODY CORPORATE AS PUBLIC COMPANY	MUTUAL INCOME
Letting Fees from Common Property (SA, NT & ACT) (para 18)		1,000		
Letting Fees from Common Property (QLD, VIC, TAS, NSW, WA) (para 17)	1,000			
Interest			500	
Dividend			200	
Access Fees (para 12)			150	
Non members			1,000	
Profits on Sale of Personal Property			2,000	
Sinking Fund (para 8)				50
Proprietors' Levy (para 7)				75
Other contributions (para 9)				15
GROSS INCOME	1,000	1,000	3,850	140
DEDUCTIONS				
Bank Fees (para 13)				35
Depreciation of personal property (para 13)			750	
Depreciation of common property (SA, NT & ACT) (para 18)		150		
(QLD, VIC, TAS, WA, NSW) (para 17)	150			
Accounting Fees				

(para 13)			100	
TOTAL DEDUCTIONS	150	150	850	35
TAXABLE INCOME	850	850	3,000	NIL