

Is it really time for change? Have we really understood the present?

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With such much tax reform occurring over the past 30 years is now really a time for change? I would suggest that we have, with such an emphasis on refining our sophisticated income tax system, overlooked basic principles. In this regard maybe it is time to refocus on the fundamentals of the income tax system. In particular our research and our teaching should be emphasising the key aspects and it may not be doing just that.

This paper will look at one of those basic areas, namely the distinction between income and capital gains. Although this is a well-known distinction, it would appear that, in practice, the distinction is not that well understood. Recently the ATO issued Taxpayer Alert TA 2014/1, which deals with Trusts mischaracterising property development receipts as capital gains. The problem would seem that developed property is subsequently sold and the proceeds returned on capital account, resulting in access to the 50% capital gains discount. The gains should in fact be returned as ordinary income, either on a gross basis if the property constitutes trading stock or a net basis, if it is forming part of a profit making undertaking.

A wider reading of this may indicate a larger problem. There may be an assumption those gains are on capital account, due to the fact that the capital gains system has been in operation since 1985 and that system seems to be the most prevalent system that is recognised, amended and taught in tax courses. The problem may be that the capital gains regime is seen as the taxing point for the disposal of property, which is of course, is an A1 event dealing with a CGT asset. There appears to be a real possibility of overlooking section 6-5 ordinary income.

The paper will examine the underlying aspects of Taxpayer Alert TA 2014/1 and see the potential impact for how the income /capital distinction and present a case for a re-evaluation of this area for income tax purposes.