

# ***TR 96/D9 - Income tax: Commonwealth benefits received by nursing homes***



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This document has been finalised by TR 97/1.



## Draft Taxation Ruling

### Income tax: Commonwealth benefits received by nursing homes

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## What this Ruling is about

### Class of person/arrangement

1. This Ruling considers the assessability of 'general care' benefits and 'capital funding' benefits paid to nursing home proprietors under sections 51 to 58CG of the *National Health Act 1953* (NHA).
2. This Ruling clarifies in what year these benefits are assessable to the nursing home proprietor under subsection 25(1) and paragraph 26(g) of the *Income Tax Assessment Act 1936* (ITAA).

## Ruling

### General care benefits

3. General care benefits received by a nursing home proprietor under sections 51 and 51A of the NHA are assessable income under both subsection 25(1) and paragraph 26(g) of the ITAA. Although paragraph 26(g) refers to amounts 'received' this has been interpreted by the courts as equivalent to 'derived' in subsection 25(1). Therefore, under either provision, the benefit is derived when the proprietor has an entitlement to receive payment.

4. The general care benefits are based on the number and classification of residents and the anticipated wage and related expenses of the nursing home. The general care benefits are paid monthly in advance. However, as the calculation of the monthly

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amount involves some estimation, an adjustment is required as at the end of the year.

5. The monthly payments represent an amalgam of components each of which is based on a 'per bed occupied' method of calculation. The monthly payment is calculated to reimburse specified expenses, grant a flat allowance for the ongoing costs of the home and give a profit component. Entitlement to the full year benefit is calculated as at the end of the year when all relevant data is available and the home's entitlement for the year can be assessed in accordance with the specified criteria.

6. Under generally accepted tax accounting principles, each advance payment is derived as income when the relevant service is provided. In relation to the nursing home benefits, the relevant service is the operation of the nursing home and consequently income is derived over the period of time during which the home cares for residents. The fact that a component of the monthly payment is calculated on the basis of expenses which may be incurred in a subsequent financial year is not relevant to the issue of the timing of derivation. It is not correct to say that the relevant service is the payment of certain expenses which form part of the calculation of the monthly payment.

7. The nursing home proprietor derives as assessable income all the payments it has properly received **and** those which it is entitled to claim as at the end of a financial year. However, where an amount has been overclaimed and is, or will be, refunded to the Department of Health and Human Services (the Department), it can be said that the amount of overpayment was not correctly receivable and has not been derived as income. Where there is an entitlement to claim additional amounts from the Department (which administers the NHA) those amounts will be derived as assessable income in the year in which the entitlement arose. That will be the year in which the resident in respect of which a payment is being sought occupied a place in the nursing home.

## Capital funding benefits

8. Capital funding benefits (available under sections 52 to 58CG of the NHA) are designed to assist in meeting the cost of carrying out improvements and extensions to nursing homes and will be assessable in the year in which the proprietor is entitled to receive payment. These amounts do not constitute recouped expenditure within the meaning of that term in subsection 160ZH(11) of the ITAA.

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## **Date of effect**

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9. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does 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 Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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## **Explanations**

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### **Outline of the methods used to calculate and pay nursing home benefits**

10. Commonwealth benefits are received by nursing home proprietors under sections 51 and 51A of the NHA. This arrangement is administered by the Department. The benefits are paid in order to defray a portion of the total costs of care provided to individual residents in the nursing home. These benefits are related to expenditure of the nursing home for employee wages and related expenses (e.g., payroll tax), liabilities for leave payments (including liabilities which accrue during the year but which may never have to be paid out, e.g., sick leave and long service leave), together with a flat allowance for non-nursing (infrastructure) costs. Although the benefits are paid as compensation for expenditure on certain types of running costs, there is no obligation on the home to spend the benefits exactly on the basis on which the entitlement is calculated. For example, funding which is based on registered nurse hours might be used for extra therapy hours.

11. Benefits generally are paid in advance at the beginning of each month. The advance is based on an estimate of the home's monthly benefit. Advance benefits are paid on the basis that specified components (e.g., wages) will actually be expended. Other components of the benefit (e.g., long service leave) are merely expected to be paid when and if the liability to pay a staff member such leave arises. The amount advanced is adjusted at the end of the month to reflect actual occupancy for that month. The difference between the assessed entitlement and the advance already made is then either paid to the home or refunded to the Department.

12. At the close of the financial year an annual reconciliation takes place where the nursing home proprietor reports the home's actual expenditure, provisions made for future liabilities (e.g., accrued sick, annual and long service leave) and nursing and administration hours over the year. These figures are reconciled against the home's entitlement, which is assessed by the Department using criteria

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relating to the number and classification of residents in the home. Tolerances are built in to the entitlements thereby avoiding the need for minor adjustments. Expenditure claimed outside these tolerances will be recognised, so that if a home has been overpaid because, for example, it made a claim based on nursing hours in excess of those to which it was entitled, it would be required to repay the excess over the tolerated amount. If the home has underclaimed, the Department will make up the amount underpaid.

13. Any overpayment identified through the reconciliation process is deducted from the home's future benefits until the overpayment has been recouped. These deductions are called negative adjustments. A positive adjustment resulting from an identified underpayment is paid immediately.

14. Adjustments are also made to leave provisions. For example, if an employee of 9 years' standing resigns, the nursing home would be required to refund to the Department all the payments it had received in relation to that employee's accrued long service leave entitlement.

## The relevant taxation principles

15. The word 'derived' is not defined in the income tax law. In its ordinary sense the word means 'receive or obtain from a source or origin; to come from a source; originate' (*The Macquarie Dictionary*, 2nd edition).

16. Where a taxpayer is assessable on an accruals basis, the courts have considered that income is derived when a recoverable debt has been created and the taxpayer is not obliged to take any further steps before becoming entitled to payment: *Farnsworth v. FC of T* (1949) 78 CLR 504; 9 ATD 33; *Henderson v. FC of T* (1970) 119 CLR 621; 70 ATC 4016; 1 ATR 596; *FC of T v. Australian Gas Light Co & Anor* 83 ATC 4800; (1983) 15 ATR 105. There may be an exception where amounts are received or receivable in advance of goods being supplied or services being provided: *Arthur Murray (NSW) Pty Ltd v. FC of T* (1965) 114 CLR 314; 14 ATD 98; 9 AITR 673).

17. In the *Arthur Murray* case, the taxpayer received amounts in advance for a specified number of dance lessons to be given over a period of time. The question was whether, in the circumstances, it could properly be held that receipt without earning makes income. In their joint judgment, Barwick CJ, Kitto and Taylor JJ said that the ultimate enquiry was whether what had taken place was enough to satisfy the general understanding among practical business people of what constitutes a derivation of income. Their conclusion was that income was not derived until the service was provided.

18. On this basis, an advance payment received by a nursing home proprietor will be earned when the nursing home has provided the service for which the benefit is received. The relevant service in relation to Commonwealth funding of nursing homes is the provision of nursing home care to residents, including doing everything that is a prerequisite to gaining and retaining Commonwealth funding.

19. Nursing home benefits are paid at the beginning of each month to fund the operation of the nursing home for that month. Where the nursing home operates in accordance with Commonwealth funding guidelines, the nursing home proprietor is not 'obliged to take any further steps before becoming entitled to payment' of the benefits (*Australian Gas Light* at ATC 4805; ATR 111) and therefore, by the end of that month, when the actual claim is lodged, the taxpayer has derived the funding which it has received (and is entitled to retain because the claim was correctly made).

20. The nursing home proprietor derives as assessable income all the payments which the proprietor was entitled to receive during the year of income. Consequently, any overpayment of benefit as at the end of the financial year has **not** been derived as assessable income and any unpaid amount for which there is an entitlement to claim as at the end of the financial year **is** derived. The annual reconciliation which occurs in the final accounting for the year in which the advance payments were received will identify any underpayments or overpayments and settle the home's entitlement for that year.

21. If the home has been overpaid in one year and its following year's benefits are reduced by a resulting negative adjustment, the nursing home proprietor will be assessable in this first year on the total monthly benefits to which it is actually entitled. The amount to be repaid through the negative adjustment system for the next year does not represent assessable income of the home for the first year as it has not been derived. Where there has been an overpayment, it is only that amount of the payment the nursing home is entitled to retain which is derived in that financial year. The negative adjustment will not reduce the assessable income of the home for the subsequent year in which the adjustment is applied.

22. Correspondingly, if the proprietor is found to have underclaimed benefits during the earlier year, so that the nursing home is subject to a positive adjustment after year end, the proprietor's assessable income for the earlier year will include the entirety of the home's entitlement, as assessed at the annual reconciliation, and the positive adjustment which will be paid to it in the subsequent year will **not** be included in the later year's assessable income as it is properly income in the (earlier) year of entitlement.

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23. Adjustments to leave provisions (for example, where an employee resigns) may create an obligation to repay some amounts received in prior years. As the amount repaid to the Department was assessable as income when received by the home in an earlier year, it will be deductible as a loss or outgoing incurred in the year of repayment. If the refund takes place by way of a negative adjustment over one or more subsequent years it will be deductible as it is repaid.

## Capital funding benefits for repairs and improvements to homes

24. Sections 52 to 58CG of the NHA entitle nursing home proprietors to benefits described as 'additional recurrent funding' to assist in meeting the costs of capital improvements. This funding is available to proprietors who satisfy Departmental guidelines. Funding is available for the purposes of upgrading sub-standard homes and for extensions to provide increased bed capacity. Applicants are eligible for payments based on a formula which takes into account the cost of the work carried out. These benefits are payable in monthly instalments over a period of 10 years.

25. These payments are assessable income under both subsection 25(1) and paragraph 26(g) of the ITAA and are derived as income in the year of receipt. *GP International Pipecoaters Pty Ltd v. FC of T* 88 ATC 4823; (1988) 19 ATR 1739 is authority for the proposition that a receipt may have an income character and consequently be assessable under subsection 25(1) notwithstanding the intention or requirement to use that receipt for the purpose of capital expenditure. As entitlement to this type of benefit is only available to approved nursing home operators, the payments are considered to represent the ordinary income of the recipient. The benefit would also be assessable under paragraph 26(g). In *First Provincial Building Society Ltd v. FC of T* 95 ATC 4145; (1995) 30 ATR 207, the Full Federal Court confirmed that section 26 of the ITAA included both income and non-income amounts in assessable income. As benefits paid under the NHA are subsidies within the meaning of paragraph 26(g) they constitute assessable income. Such amounts do not constitute recouped expenditure within the meaning of that term in subsection 160ZH(11) of the ITAA.

## Alternative view

26. It has been suggested that the service relevant to determining the time of derivation of nursing home benefits is the actual expenditure of benefits in the exact manner anticipated when the claim for benefits is made. It is argued that the component of the benefit which related to, say, long service leave, would only be derived as income if the long

service leave had been paid by the nursing home. This view relies on the characterisation of the relevant service as 'the obligation to expend benefits in the exact manner in which they were calculated', i.e., identified sums for wages, long service leave, workers' compensation and other expenses. For example, Commonwealth benefits received to pay staff salaries generally will be expended during the year of income for which the benefits are paid. However, homes are also funded to provide for sick leave, annual leave and long service leave, etc. As long as the home accounts for these liabilities through the provision system, there is no requirement by the Department that the homes pay out these amounts in the year in which they are funded.

27. As noted above, these factors are relevant to the calculation of the amounts paid to the nursing homes to defray a proportion of the cost of care provided to the residents and there is no obligation on the home to spend the benefits exactly on the basis on which the entitlement is calculated. The Department makes monthly payments so that residents are able to receive an appropriate level of care provided by nursing homes. The provision of that care is the relevant 'service' and accordingly there should be no deferral of the derivation of any identified component of the monthly payment until that component has been spent.

28. The argument that the various components of the monthly payment can be separately identified, such that each component represents a requirement to perform a service which is a necessary precondition to the derivation of that amount as income, does not reflect the funding entitlements of nursing homes.

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## **Example**

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29. A nursing home is in receipt of Commonwealth benefits provided under sections 51 and 51A of the NHA. At the commencement of the month of March 1993, it submits an application for advance payment of the Commonwealth benefit based on the number and classification of the residents in the home in January. As is required by the Department, at the completion of the month the home prepares its claim for March by comparing its actual occupancy with the claim submitted to the Department at the commencement of the month. It is discovered that the home underclaimed on numbers of residents when lodging the claim at the commencement of the month due to an increase in the number of occupied beds during the course of that month.

30. Under the Departmental guidelines, the home is entitled to an additional benefit relating to the increased number of beds for March.



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The additional benefit for March will be paid to the increased level of entitlement when the home lodges its formal application.

31. After 30 June 1993, the home reports to the Department its actual wage expenditure and staff hours for the year just concluded. In calculating the home's entitlement for the year, the Department determines that the home has claimed expenditure during the year in excess of its entitlement and which falls outside the Department's allowed tolerances. The Department therefore requires the expenditure in excess of the amount tolerated to be repaid by the home. To achieve repayment, the Department applies a negative adjustment to the benefits otherwise payable for the year ended 30 June 1994. These adjustments will apply until the excess benefits have been recouped by the Department.

32. The nursing home will be assessed on the benefits received for the year ended 30 June 1993, including the make-up payment for March, less the amount identified at the annual reconciliation as an overpayment for the year. For the year ended 30 June 1994, the home will be assessed on the full benefits to which it is entitled, not on the reduced amount received which results from the application of the negative adjustment referable to the overpayment in the year ended 30 June 1993.

## Your comments

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33. If you wish to comment on this Draft Ruling, please send your comments by: 31 May 1996

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**Commissioner of Taxation**

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- ITAA 25(1)
- ITAA 26(g)
- ITAA 160ZH(11)
- NHA 51
- NHA 51A
- NHA 52
- NHA 58CG

*case references*

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- First Provincial Building Society Ltd v. FC of T 95 ATC 4145; (1995) 30 ATR 207
- GP International Pipecoaters Pty Ltd v. FC of T 88 ATC 4823; (1988) 19 ATR 1739
- Henderson v. FC of T (1970) 119 CLR 621; 70 ATC 4016; 1 ATR 596