


IT 2526 - Income tax : averaging of incomes - application of section 155 of the Income Tax Assessment Act permanent reduction of income

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TAXATION RULING NO. IT 2526

INCOME TAX : AVERAGING OF INCOMES - APPLICATION OF
SECTION 155 OF THE INCOME TAX ASSESSMENT ACT
PERMANENT REDUCTION OF INCOME

F.O.I. EMBARGO: May be released

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REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I1011158	AVERAGING PROVISIONS - APPLICATION OF PERMANENT REDUCTION OF INCOME	155

PREAMBLE The purpose of this ruling is to restate the Commissioner's view of the construction of section 155 of the Income Tax Assessment Act ("the Act") following a recent decision of the Administrative Appeals Tribunal (Mr. B.J. McMahon, Senior Member) reported as Case V120 88 ATC 753 ; AAT Case 4510 19 ATR 3723 that a subsistence farmer was entitled to the benefit of the section.

2. Section 155 of the Act provides:

"Where a taxpayer establishes that, owing to his retirement from his occupation, or from any other cause (but not including a change in the investment of assets from which assessable income was derived into assets from which the taxpayer derives income which is not liable to be assessed under this Act), his taxable income has been permanently reduced to an amount which is less than two-thirds of his average taxable income, he shall be assessed, and the provisions of this Division (Division 16) shall apply to the income thereafter derived by him, as if he had never been a taxpayer before that year."

3. The broad purpose of the averaging of income provisions in the Act is to ensure that taxpayers (other than companies) who carry on a business of primary production in Australia and who have fluctuating incomes are not required to pay greater tax over a number of years than those on comparable but steady incomes.

4. While the averaging provisions are advantageous to a primary producer in years where his taxable income is increasing, they may be disadvantageous in years where his taxable income is decreasing. Section 155 of the Act can operate to ameliorate the latter situation.

5. The general effect of Section 155 is that a primary producer

may have calculations of his average incomes started a-fresh, with high taxable incomes of earlier years being excluded, where because of retirement from his occupation or because of some other cause his taxable income has been permanently reduced to the specified level.

FACTS

6. In Case V120 ; AAT Case 4510 the taxpayer had lived on a family farm. At the age of 19 he started an apprenticeship as a motor mechanic with his local Water Resources Commission ("WRC") which he completed 4 years later. During the period of the apprenticeship the taxpayer continued to work on the family farm on weekends and on other occasions when he had the time. The farm being operated on a share farming basis by members of the family, the taxpayer's work on the farm entitled him to a share of the profits of the farm. His income was averaged under the provisions of Division 16.

7. Evidence was accepted by the Tribunal that the taxpayer did not intend to pursue a career as a motor mechanic but that he had only undertaken the apprenticeship to acquire the skills required to repair farm machinery. The taxpayer had always intended to return to work on the family farm on a full-time basis on the completion of the apprenticeship.

8. When the taxpayer left his salaried employment with the WRC for full-time work on the farm his taxable income dropped to a level less than two-thirds of his average taxable income. He claimed the benefit of section 155 of the Act.

DECISION

9. The Tribunal found that the requisite reduction in the level of the taxpayer's income was "permanent" and that the taxpayer was entitled to the benefit of section 155. The Tribunal said that it did not have to decide whether the reduction in income had been brought about by a retirement from occupation because the wording of the section was wide enough to cover a reduction brought about by "any other cause". By way of obiter dicta the Tribunal did say that "retirement" for the purposes of section 155 did not mean the completion of life's labours or an intention to give up any prospect of gainful employment.

10. In the Tribunal's view, what the taxpayer had to primarily establish was that his taxable income had been permanently reduced to the appropriate level. Whether the reduction was permanent or not was to be decided in the year in which the reduction occurred. "Permanent" for the purposes of section 155 meant "indefinitely continuing" (c.f. FC of T v. Austin (1932) 48 CLR 590 at 601-602) or "permanent, as distinct from temporary" (c.f. McDonald v. Director-General of Social Security 6 ALD 6 at 13).

11. In finding that the reduction was permanent, the Tribunal had regard to the taxpayer's evidence that he would never contemplate working for somebody else, to the unlikelihood of either the taxpayer's father retiring and leaving the property to the sons or the sons being able to afford to buy out the

father's interest, to the limited scope for enlarging the property due to its geographical location (next to a salt pan), and to the evidence of the taxpayer's accountant that the taxpayer was typical of a number of his clients who had very low taxable incomes (in some cases losses) and who often relied on a salary earned by a spouse to supplement their income. Some of this evidence had not been available to the Commissioner at the time he determined the taxpayer's objection.

12. The Tribunal found that the mere existence of other options to increase income is irrelevant if it is not shown that there is a likelihood of the taxpayer taking up the option. Similarly speculations as to possible increases in future income must be based on likelihoods or probabilities not on possibilities.

RULING

13. The Commissioner accepts that the conclusion of the Tribunal was open to it on the evidence adduced.

14. Income Tax Order ("ITO") 1189 dated 12 May 1928, considered sub-section 13(9) of the Income Tax Assessment Act (1922). That section was the exact counterpart of the present section 155. Paragraph 15 of ITO 1189 states:

"The significant words of this provision (sub-section 13(9)) of the law are "permanently reduced" Whether or not the question is capable of answer at the time of assessment depends entirely upon the facts of the particular case. It would be capable of affirmative answer in the case of a person who had relinquished one income to receive a lesser income with the obvious intention of continuing to accept and receive the lesser income, even although he might, by judicious investment of savings, greatly increase his total income. It would also be capable of an affirmative answer in a case where a taxpayer, by entering upon a new occupation, caused a reduction in his income below the required amount if it is demonstrated that the change of occupation is definite and intended to be continued as long as possible."

15. Canberra Income Tax Circular Memorandum (CITCM) No.88 also considered sub-section 13(9) of the 1922 Act. It states (at page 3):

"The words 'or from any other cause', immediately following as they do, the words "owing to his retirement from his occupation" must, on well known principles of statutory construction, be taken to mean any other cause similar in character to retirement from an occupation. These words would, therefore, include such a cause of a change in occupation brought about by termination of an engagement by expiration of time, or by notices, or by the happening of some specified event, or by dismissal, and a change in employment from one business to another business, even though the two businesses (are) of a similar kind would be a change of occupation".

16. The Commissioner accepts that the decision of the Tribunal

is consistent with ITO 1189 and CITCM 88. This ruling confirms that the passages referred to above reflect the Commissioner's current policy in relation to the operation of section 155

17. The decision of the Tribunal also illustrates the considerations relevant to the determination under section 155 of whether a taxpayer has established that there is a permanent reduction of taxable income.

COMMISSIONER OF TAXATION

4 May 1989