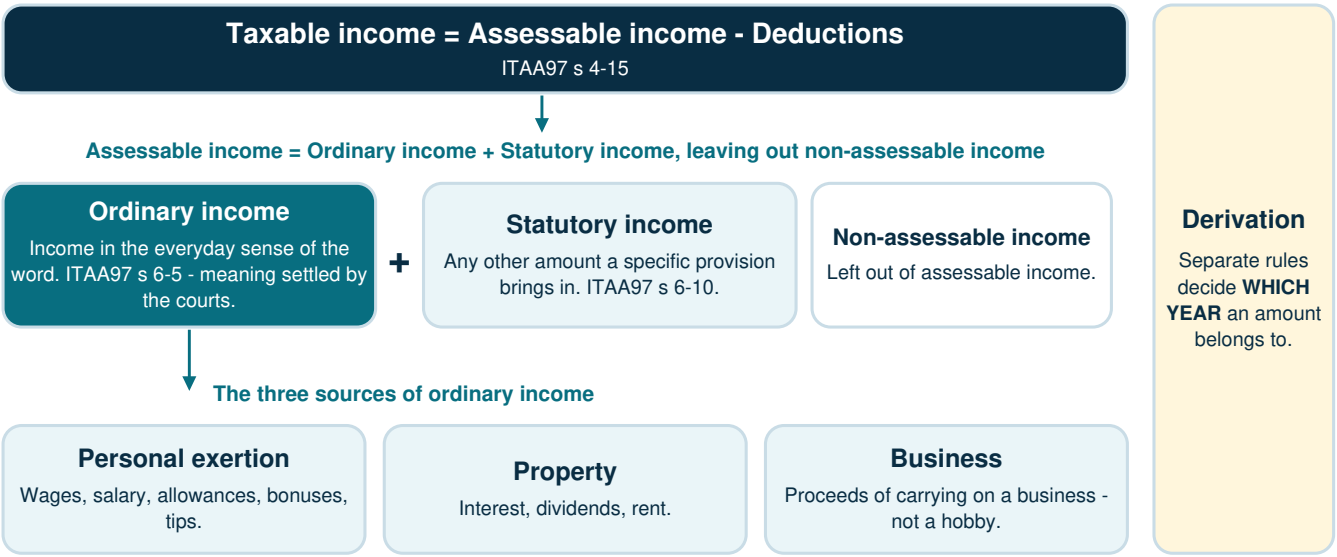
Ordinary income and the capital line

MODULE 2 | 2.4.1 | STUDENT COMPANION

Ordinary income is the first component of assessable income, yet the Act does not define it. The courts recognise it by a set of features, weighed together, and by its three sources: personal exertion, property and business. A capital receipt is not ordinary income, so every receipt has to be placed on one side of the income-capital line.

Where ordinary income fits

The two equations. Taxable income = assessable income - deductions (ITAA97 s 4-15). Assessable income = ordinary income (s 6-5) + statutory income (s 6-10), leaving out non-assessable income. The derivation rules decide which year an amount belongs to.



Income according to ordinary concepts

No definition. Section 6-5 brings "income according to ordinary concepts" into assessable income and says no more. The courts look for features that income usually has. They are indicators only.

1. It comes in - for your benefit

Income is what arrives, not what you avoid spending. An unrealised gain is not income. Constructive receipt: an amount dealt with as you direct is treated as received - s 6-5(4).

2. Money or money's worth

Money, or something that can be turned into money. A barter deal counts at its value (IT 2668).

3. Often regular

Regular, recurrent or periodic - often, not always. A lump sum usually points to capital but can be income. A capital sum paid in instalments is still capital.

4. Product of exertion, property or business

The normal proceeds of personal exertion, property or business.

5. Judged from the recipient's side

Test the receipt for the person receiving it, not the person paying it.

6. Legal or illegal - same tests

Proceeds of illegal activities can be assessable (TR 93/25).

Outside ordinary income: capital receipts, and windfalls such as a lottery win.

- **Comes in.** Income is what comes in, not what is saved, and an unrealised gain is not income. Under s 6-5(4) an amount applied or dealt with on your behalf, as you direct, is treated as received (constructive receipt).
- **Money or money's worth.** Goods or services received in a barter deal are assessable at their value (IT 2668).
- **Regularity.** A common sign, but not essential: a lump sum can be income, and instalments of a capital sum stay capital.
- **Recipient's side.** Character is tested for the person who receives the amount, not the payer.
- **Legality.** The same tests apply to illegal activities (TR 93/25).

The three sources

Source	Typical receipts	Remember
Personal exertion	Wages, salary, allowances, bonuses, tips	Income even if irregular, voluntary or paid by a third party. A prize won through income-earning activities also counts
Property	Interest, dividends, rent	A return on capital invested
Business	Proceeds of trading	Not a pastime or hobby

Worked illustration: Ottoline Kirkbride, piano tuner, 2024-25

Item	Amount	Ordinary income?
Fees from customers	$88,000	Yes - business proceeds
Catering received for a tuning	$900	Yes - money's worth
Fee sent to her supplier at her direction	$1,500	Yes - constructive receipt
Interest	$600	Yes - property
Rise in value of unsold shares	$5,000	No - unrealised
Tuning her own piano	$300	No - a saving
Total ordinary income	**$91,000**	**$88,000 + $900 + $1,500 + $600**

Income or capital

Why it matters. Income is assessable in full and taxed at marginal rates. Capital is outside s 6-5, although CGT may apply to assets acquired on or after 20 September 1985 (Module 3).

	Income	Capital
Tree and fruit	The fruit the tree bears. **Example:** dividends on a parcel of shares	The tree. **Example:** the shares themselves
In a business	Circulating capital - profit is made by parting with it. **Example:** the bicycles on a bicycle shop's floor (trading stock)	Fixed capital - kept and used to earn profit; part of the profit-yielding structure. **Example:** the shop fit-out and workshop stands
Tax result	The whole amount is assessable (s 6-5) and taxed at marginal rates	Not ordinary income. CGT may apply to assets acquired on or after 20 September 1985 (Module 3)

Sold only once?

Starting point - a one-off sale that simply realises an asset is capital. But the gain is income when the sale goes beyond realising an asset or changing an investment and is really a step in carrying on a business (Californian Copper Syndicate v Harris). A question of fact and degree.

One-off sales. Simply realising an asset is capital. A gain is income where the sale is really a step in carrying on a business (Californian Copper Syndicate v Harris), and the business can be read widely. A hire business that regularly sells its ex-hire equipment may be assessed on those profits (FCT v GKN Kwikform Services; Memorex v FCT), but not where the equipment was never acquired for resale (FCT v Hyteco Hiring; FCT v Cyclone Scaffolding). It is a question of fact and degree.

Practice questions

MODULE 2 | 2.4.1 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Ten events in one year

Lavinia Farnham is employed as a veterinary nurse. On weekends she also runs a dog-training business (accept that it is a business). The events in the table happened in the 2024-25 income year.

No.	Event	Amount	Ordinary income?	Deciding feature
1	Salary from the veterinary clinic	$62,000		
2	Cash handed to her at Christmas by grateful pet owners at the clinic	$1,200		
3	A performance bonus which, at her written request, the clinic paid straight to the lender for her car loan	$2,400		
4	Dog-training fees received from customers	$9,000		
5	She trained an electrician's dog. Instead of paying her usual fee, he rewired her garage, a job for which he normally charges the same amount	$600		
6	Interest on a term deposit	$800		
7	Her listed shares rose in value from $20,000 to $26,000. She sold none	$6,000		
8	She sold, in one lot at auction, a coin collection she inherited from her grandfather in 2015	$9,000		
9	She repainted her own flat. A painter had quoted this amount for the job	$3,000		
10	She won a raffle at her netball club	$250		

(a) For each event, state whether the amount is ordinary income under ITAA97 s 6-5, and name the feature of ordinary income that decides it. (b) Calculate Lavinia's total ordinary income for 2024-25.

Question 2 - Which side of the line?

Larkmoor Kayak Hire Pty Ltd hires kayaks to holidaymakers on a river. Its records for 2024-25 show the items in the table. For each item, state whether it falls on the income side or the capital side of the line, or is not a receipt at all, and explain why.

No.	Receipt or event	Amount	Income, capital or not a receipt? Why?
1	Hire fees from customers	$410,000	
2	Proceeds from selling the season's used kayaks. Every April since it began, Larkmoor has sold its whole fleet of about 70 kayaks to the public and bought new ones for the next season. Its budgets and hire prices are set on the footing that these sales will happen	$49,000	
3	Interest on its business savings account	$3,000	
4	The first of three equal annual instalments from the sale of a riverside block. Larkmoor bought the block in 2014, used it as its launching site and car park, and sold it for $240,000 when it moved its operations downstream	$80,000	
5	A valuer reports that the boat shed Larkmoor owns rose in value during the year. The shed has not been sold	$150,000	

Question 3 - Three things a client says

Casimir Hargreave is a self-employed illustrator. He makes three statements about his 2024-25 income year. Explain why each statement is wrong, naming the principle and any authority, and state the amount of ordinary income involved. (a) "A publisher owed me $5,000 for a book cover. I asked it to pay the money straight to my sister, to repay a loan she made me. The money never touched my bank account, so it is not my income." (b) "A winery could not afford my fee for a new label, so it gave me twelve cases of its wine, which sell for $2,400 in total. No money changed hands, so there is nothing to declare." (c) "A magazine paid me a single lump sum of $8,000 for a one-off series of twelve drawings. It was a one-off lump sum, so it must be capital."

Worked answers

MODULE 2 | 2.4.1 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Answer 1 - Ten events in one year

No.	Ordinary income?	Amount included	Deciding feature
1	Yes	$62,000	Normal proceeds of personal exertion (salary)
2	Yes	$1,200	Personal exertion. A voluntary payment from a third party is still income when it is a product of the employment, like a tip
3	Yes	$2,400	Personal exertion, received by constructive receipt. The bonus was dealt with as she directed, so s 6-5(4) treats her as having received it
4	Yes	$9,000	Normal proceeds of carrying on a business
5	Yes	$600	Money's worth. A barter deal is assessable at the value of what is received (IT 2668)
6	Yes	$800	Income from property - a return on capital invested
7	No	nil	Nothing has come in. An unrealised gain is not income
8	No	nil	A capital receipt. She has simply realised an inherited asset in a single sale, outside any business. (Whether CGT applies is a Module 3 question)
9	No	nil	A saving is not income. Income is what comes in, not what is saved from going out
10	No	nil	A windfall. A raffle win is a matter of chance and has no connection with any income-earning activity

(b) Total ordinary income = $62,000 + $1,200 + $2,400 + $9,000 + $600 + $800 = **$76,000**.

Running total: $62,000 -> $63,200 -> $65,600 -> $74,600 -> $75,200 -> $76,000.

Answer 2 - Which side of the line?

No.	Side of the line	Why
1	Income side - $410,000	These are the normal, recurring proceeds of carrying on the hire business, so they are ordinary income under s 6-5.
2	Income side - $49,000	A hire kayak looks like fixed capital, because it is kept and used to earn hire fees. But the business can be read widely. Selling the whole fleet every year is a regular, planned and built-in part of the way Larkmoor makes its money, so the sales are a step in carrying on its business and not a mere realisation, and the profit on them is ordinary income (FCT v GKN Kwikform Services; Memorex v FCT). Contrast a hire business that bought its equipment only to hire out, with no thought of resale, and sold items occasionally: there the gain has been held to be capital (FCT v Hyteco Hiring; FCT v Cyclone Scaffolding). It is a question of fact and degree, and on these facts the income side is the better view.

No.	Side of the line	Why
3	Income side - $3,000	Interest is income from property: the fruit, where the money on deposit is the tree.
4	Capital side - $80,000	The block was fixed capital, part of the structure the business operated from. Larkmoor is not in the business of selling land, and it sold the block once, because it relocated: a mere realisation of a capital asset. Payment by instalments does not change that. A capital sum is still capital when it is received in regular instalments, so all three instalments ($80,000 x 3 = $240,000) are capital. The sale is not ordinary income. Because the block was acquired after 20 September 1985, CGT has to be considered (Module 3).
5	Not a receipt at all - $150,000	Nothing has come in. An unrealised gain is not ordinary income. (If the shed were sold one day, it would be the sale of fixed capital.)

Answer 3 - Three things a client says

- **(a)** Wrong because of constructive receipt. Income does not have to reach the taxpayer's own hands or bank account. Under ITAA97 s 6-5(4) a person is taken to have received an amount as soon as it is applied or dealt with on their behalf, as they direct. Casimir earned the fee and directed where it went, so it is the proceeds of his business. Ordinary income: **$5,000**. (Repaying his sister is simply how he chose to spend it.)
- **(b)** Wrong because ordinary income is money or money's worth. The wine can be turned into money, and he received it in return for his services, so this is a barter transaction and it is assessable at the value of what he received (IT 2668). Ordinary income: **$2,400**.
- **(c)** Wrong because regularity is a common feature of income but not an essential one, and the form of a payment does not decide its character. The $8,000 is a reward for drawings produced in the ordinary course of his illustration business: the normal proceeds of personal exertion and business. Capital would be the sale of part of the profit-yielding structure, and he has sold nothing of that kind. Ordinary income: **$8,000**.

Total ordinary income across the three statements = $5,000 + $2,400 + $8,000 = **$15,400**.