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Keywords

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Are returns received by householders from electricity generated by solar panels assessable income?

John Passant^{*}, John McLaren[#] and Parulian Silaen[≈]

Abstract

More than one million households in Australia are generating electricity from solar photovoltaic panels installed on their homes and they receive a credit or payment, namely a return in some form for the electricity generated. The focus of this paper is on domestic households and the returns they receive from solar panels installed on their roofs. This paper contends that such returns in the form of a credit or actual payment to households for electricity generated from solar panels is ordinary income from property and should be treated as assessable income. Where the electricity generated is fed back into the household it will not be assessable income, but in all those cases where the electricity is fed into the grid and a payment or credit is given then that return is income according to ordinary concepts and assessable as such. If the government wants to encourage investment in solar energy by householders in Australia then they should clarify this issue by passing legislation exempting the returns from assessable income. Alternatively the Australian Taxation Office (ATO) could release a public ruling on the issue. This at least would provide greater certainty for households who now tentatively rely on private rulings given to taxpayers by the ATO that consider credits and payments not to be assessable income on the basis that the householder is not conducting a business or that the arrangement is of a private or domestic nature.

I INTRODUCTION

This paper contends that solar panel generated electricity payments and credits made to private householders are returns from property and therefore income according to ordinary concepts. It is also contended that electricity fed directly into the home for domestic purposes is not a payment or receipt but saves expenditure. It is not income, while any excess fed into the grid that leads to a payment or credit is income. It is argued that this is the correct application of the

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current taxation law to the payment or crediting to households with solar panels for generated electricity. If this is correct, then over a million households in Australia are facing uncertainty because the ATO has not yet adopted a settled position through the public rulings process. There is no legislation which excludes the returns from assessable income. There is no case law on this particular question. On the contrary, the ATO could start assessing the payments and credits for income tax purposes at any time in the future, especially if the interest in solar energy by households continues to grow.

In light of the view contained in the private rulings issued by the ATO that the householders are either not carrying on a business¹ or that the arrangements are of a private or domestic nature² or both³ and therefore the returns are not income, it is argued in this paper that the ATO should re-examine the issue in depth and issue a public ruling on the subject to clarify the tax treatment of such returns or, depending on the outcome, recommend to government that it amend the *Income Tax Assessment Act* accordingly. The best outcome for some households with solar panels and the one that provides immediate certainty would be for the government to exempt such returns from income tax and to do this on a pre-emptive basis, before the ATO finalises its position. Of course, for those who have borrowed money or will borrow money to pay for the installation of solar panels the best outcome may be to have the returns included in assessable income and thus potentially create a tax loss which can then be offset against other income, depending on the particular circumstances of the taxpayer.⁴

This paper looks at whether the returns in the form of payments and credits should be included in the householder's assessable income and concludes that contrary to current ATO thinking as revealed in a number of private rulings, the returns are assessable. If that is the case a number of consequences may flow including the possible application of the Goods and Services Tax to such returns; the possible implications for the capital gains tax main residence exemption to be effected; the application of the non-commercial loss provisions; the nature of the returns in the hands of lessees and not the legal owners; the renewable energy certificates as assessable recoupment and finally the position of negatively geared solar panel installations. However, this paper is concerned only with the threshold question, namely whether the returns are assessable income and not what may or may not flow as a consequence of establishing that the returns are assessable income. Part II of this paper provides a general background to the issue and Part III explains the types of schemes under which returns for solar panel generated electricity can be made. Part IV of the paper looks at the ATO's views about the income nature of the returns

¹ See for example Private Ruling Authorisation Number: 92481

<<http://www.ato.gov.au/rba/content/?ffi=/misc/rba/content/92481.htm>>.

² See for example Private Ruling Authorisation Number: 1012175678796

<<http://www.ato.gov.au/rba/content/?ffi=/misc/rba/content/1012175678796.htm>>.

³ See for example Private Ruling Authorisation Number: 1011926964102

<<http://www.ato.gov.au/rba/content/?ffi=/misc/rba/content/1011926964102.htm>>. This seems to be the more favoured approach of late.

⁴ This would create a similar situation to that of investors that negatively gear the purchase of an investment property and claim interest deductions as well as depreciation deductions.

which are primarily contained in various Private Binding Rulings. Part V examines some basic income tax concepts which are then applied to the returns in order to substantiate the arguments presented in this paper. Part VI concludes that the payments are income from property and should be included in assessable income and that the credits are, except where they expire, constructively received by the householder and so should also be included in assessable income. Where there is a feed in of electricity from the solar panels to the home, it is acknowledged in this paper that the saved expenditure is not income.

II BACKGROUND TO THE ISSUE

According to the Clean Energy Regulator more than one million households in Australia are now equipped with solar photovoltaic panels.⁵ For those one million households, or approximately 2.5 million Australians,⁶ the consequences of not having the taxation situation resolved one way or the other is that investment in solar energy by households may wane and any reduction in Australia's carbon emissions will subsequently be affected or frustrated. It is for this reason that a defensible and settled view of what the appropriate tax treatment should be for these returns is of vital importance.⁷ As the United Nation's Intergovernmental Panel on Climate Change warns again of the increased warming of the planet and the major role human activity plays in that,⁸ the search for alternatives to greenhouse gas emitting fossil fuels has become global. Governments and business around the world are or have invested in solar⁹ and wind farms¹⁰ and wave and tidal energy.¹¹ In Australia, encouraging the development of these alternatives has included the former Labor Government putting a price on carbon, known as the carbon tax,¹² which has now been

⁵ Clean Energy Regulator, 'One million solar panel systems installed under the Renewable Energy Target' 5 April 2013 <<http://ret.cleanenergyregulator.gov.au/Latest-Updates/2013/April/one-million-solar-panel-systems-installed>>.

⁶ Sophie Vorrath, 'Solar milestone: 1,000,000 PV systems installed in Australia' *Renew Economy* 5 April 2013 <<http://reneweconomy.com.au/2013/solar-milestone-1000000-pv-systems-installed-in-australia-44201>>.

⁷ This paper deals with the primary question of whether solar panel returns to householders are income according to ordinary concepts and hence whether they are to be included in assessable income. It also covers the related question of feed-ins direct from panels to the home for domestic purposes. It does not deal with the consequences that may flow from any determination that such returns are to be included in assessable income.

⁸ International Panel on Climate Change, 'Headline Statements from the Summary for Policymakers' (IPCC 27 September 2013) <http://www.ipcc.ch/news_and_events/docs/ar5/ar5_wg1_headlines.pdf>.

⁹ Global capacity has doubled between 2012 and 2013. See 'Wiki-Solar map of worldwide utility-scale solar projects' <<http://wiki-solar.org/map/world.html>> and Joshua Hill, 'Global big solar capacity doubles to more than 12 GW' *RenewEconomy* 25 February 2013 <<http://reneweconomy.com.au/2013/giant-solar-farm-capacity-doubling-inside-12-months-breaking-12-gw-22980>>.

¹⁰ According to the Global Wind Energy Council, 'wind power is present today in over 79 countries, with 24 countries having more than 1,000 MW installed.' GWEC interactive map, <http://www.gwec.net/global-figures/interactive-map/>.

¹¹ See, for example, Tildy Bayar, 'Largest European Tidal Energy Project Moving Forward', *Renewable Energy World* 16 September 2013 <<http://www.renewableenergyworld.com/rea/news/article/2013/09/largest-european-tidal-energy-project-granted-consent-in-scotland>>.

¹² See the *Clean Energy Act 2011*. For a discussion of that Act and associated Acts from a critical perspective see John Passant, 'Australia's Carbon Tax – The Sweet and The Sour' (2011) 65 *Bulletin of International Taxation* 12.

repealed by the current government. This is to be replaced by a direct action plan.¹³ The former Labor Government complemented the price on carbon with a Renewable Energy Target scheme based on Renewable Energy Certificates (RECs) for both large scale and small scale providers.¹⁴ For example, households purchasing solar panels for their rooftop could sell the RECs for them to the provider, thus reducing the price of the panels and their installation.

State and Territory governments in Australia not only assisted in the development of large scale solar farms¹⁵ but also, until recently, offered very attractive incentives to individual households to put electricity generating solar panels on their roofs. Those incentives, known as feed-in-tariffs, have typically included a price for the purchase by commercial providers of electricity from households at not only above the wholesale price but also the retail price. The payment to the individual householder may be in the form of cash, or a credit against household electricity use, with any excess either lost or paid out as cash at some time in the future, or a combination of all of the options. The very success of the various State and Territory solar panel subsidy schemes has seen them wound back as the cost to the State and Territory governments began to spiral and the increasing use of solar panel electricity cut the profits of traditional electricity suppliers. Feed-in tariff subsidies are also being wound back in every State and Territory. As Nigel Morris says:

We also had feed-in tariffs come and go around Australia. They blossomed in 2010, matured in 2011 and 2012 and in almost all states have now wilted and been returned to the earth as history. If you export energy today in Australia the best you are likely to get is around 8c/kWh which is roughly equivalent to the wholesale generation cost of coal fired energy.¹⁶

The Queensland government for example reduced the tariff from 44 cents per kilowatt hour to 8 cents per kilowatt hour.¹⁷ The Australian Capital Territory (ACT) government has abandoned subsidies and payment comes from the electricity retailer. In the case of one commercial electricity supplier, 'ActewAGL', this is the net amount after consumption has been deducted and if there is an excess payment it is at 'the customer's energy tariff rate.'¹⁸ Using the ACT as a

¹³ Tony Abbott, 'The Coalition's Plan to Abolish the Carbon Tax', The Liberal Party of Australia, 29 June 2012, <http://shared.liberal.org.au/Share/HRO_CT_doc.pdf>.

¹⁴ Department of the Environment, 'Enhanced Renewable Energy Target Factsheet' <<http://www.climatechange.gov.au/reducing-carbon/renewable-energy/renewable-energy-target/enhanced-renewable-energy-target>>. For small scale technology certificates (STCs) for solar panels, for example, the result is usually that installers of these systems usually offer a discount on the price of an installation, or a cash payment, in return for the right to create the STCs.

¹⁵ For example, through an auction process, the Australian Capital Territory government has set in train 3 solar farms for the Territory, to be run by private enterprise. They will provide enough power for 10,000 Canberra homes. See Lisa Maloney, 'Two new solar farms for the ACT' *ABC News*, 19 August 2013 <<http://www.abc.net.au/news/2013-08-19/new-act-solar-farms/4896912>>.

¹⁶ Nigel Morris, 'Fossil fuel subsidies vs renewable energy subsidies in Australia: Get the facts' *Solar Choice*, 27 February 2014 <<http://www.solarchoice.net.au/blog/news/fossil-fuel-subsidies-vs-renewable-energy-subsidies-in-australia-260214/>>.

¹⁷ Ibid.

¹⁸ ActewAGL, 'ActewAGL Solar buyback scheme' <<http://www.actewagl.com.au/Product-and-services/Offers-and-prices/Prices/Residential/ACT/Feed-in-schemes/ActewAGL-Solar-buyback-scheme.aspx>>.

typical jurisdiction, ActewAGL highlighted this trend to reduced or abandoned subsidies when it said:

The ACT Feed-in Tariff scheme is based on gross generation, so you are paid for each unit of electricity that you generate. Most other jurisdictions only pay you for any energy left after deducting your own consumption. From commencement of the scheme until 30 June 2010 this amount will be 50.05¢ per kWh generated for systems up to 10kW. For systems between 10kW and 30kW a rate of 40.04¢ per kWh will be paid. For customers who are eligible and sign up after 1 July 2010, this amount will be 45.7¢ per kWh generated for systems with a capacity up to 30kW.¹⁹

This latter eligibility ended at first instance on 31 May 2011 and was re-opened on 12 July 2011 but closed on 13 July 2011 because of overwhelming demand.²⁰ The result is that any householder in the ACT who installs solar panels after that date is no longer eligible for any ‘government feed-in tariff’. They are, however, eligible for ActewAGL’s Solar Buy Back Scheme. As ActewAGL says:

If at any time the customer is an exporter of energy, then ActewAGL will purchase the energy exported at the price stated in the schedule of charges (currently 7.5 cents per kWh). The customer will pay the published tariffs for the energy imported for their use from the electricity grid.²¹

In essence this Scheme gives a credit against the cost of personal consumption, effectively a constructive payment at the retail price if the household is on a standard plan at the present of 20.130c per kWh, and if there is any surplus electricity generated above the consumers’ personal needs, it is purchased at the current wholesale price of 7.5c per kWh. The same taxation principles apply to returns for solar panel generated returns, irrespective of whether they are paid at a premium or not or are paid or credited at wholesale or retail prices.

III GROSS OR NET SCHEMES

There are two different ways of viewing gross and net schemes. For the purpose of this paper they are described as the ‘industry’ view and the ‘ATO’ view. The industry view focuses on the payments to the householder in terms of them being a net or a gross return whereas the ATO view looks at the supply of electricity in terms of a net or a gross supply to the electricity company.

¹⁹ ActewAGL, ACT Feed-in-Tariff scheme <<http://www.actewagl.com.au/Product-and-services/Offers-and-prices/Prices/Residential/ACT/Feed-in-schemes/ACT-feed-in-scheme.aspx>>. For details of the closure of the scheme, see ACT Government Environment and Sustainable Development Directorate, ‘Feed-in-Tariff Scheme’ <<http://www.environment.act.gov.au/energy/fit>>.

²⁰ Ibid.

²¹ ActewAGL, ‘ActewAGL Solar Buyback Scheme’ <<http://www.actewagl.com.au/Product-and-services/Offers-and-prices/Prices/Residential/ACT/Feed-in-schemes/ActewAGL-Solar-buyback-scheme.aspx>>.

In terms of the industry perspective when discussing gross feed-in tariff schemes and net feed-in tariff schemes, the industry view is based on the idea that the receipt can either be a gross receipt for all electricity generated, or a net receipt after taking into account the household's actual electricity use and offsetting the cost of that against the amount owed by the electricity company for electricity fed into the grid. In both cases the amount of the receipt may then be paid or credited to the household. In some net feed-in cases credits, if large enough, are accumulated to be offset against future household consumption. If there are any unused accumulated amounts they expire after a certain period if they are not being used, such as a 12 month period.

The ATO's view of what net and gross schemes are is found in the various private tax rulings. It should be noted that there is no reference in the private rulings to term 'feed-in tariffs'. The key is whether or not the electricity generated is fed first into the home for domestic use or directly into the grid. The ATO describes those solar panel systems that feed electricity into the home when domestic appliances are used and which export any 'left over' electricity to the grid as net schemes. It calls those which export all the electricity to the grid as gross schemes. In a number of private rulings the ATO makes the following assertion in determining whether or not the payments are assessable income. For the ATO the terms of the arrangement with the electricity retailer and in particular whether the solar system is configured into the electricity system of the home are of great importance. If the solar system first supplies electricity to the home to satisfy household electricity consumption before exporting excess electricity to the grid, this is referred to as a 'net' scheme, or if the solar system exports all electricity to the grid this is referred to as a 'gross' scheme.

In this paper both schemes, the industry and the ATO are discussed. The gross and net feed-in approaches lead to different income tax outcomes in relation to amounts used directly for household purposes. The industry view is based on the payments or credits given for electricity supplied to the grid, and the tax outcome may depend on the derivation of those receipts and their ability to be converted into money or money's worth. For that reason it is also important to be aware of the variety of the payment arrangements that may exist in relation to both gross and net schemes.

Once the solar panels have been installed on the roof of the homeowner, the local electricity supplier enters into a contract with the homeowner to take the surplus electricity generated from solar energy. This takes the form of a 'feed-in tariff' and this can be either a gross or a net scheme. Under a 'gross feed-in tariff scheme' the provider, namely the householder, receives payment for all of the electricity generated. Under a 'net feed-in tariff scheme' the provider has their own private electricity consumption netted off against the solar panel electricity generated payment and receives a net payment or in some cases a credit. In some instances the payment or credit is time limited in the sense that the credit has to be offset within a certain time such as a period of 12 months against future electricity use at the payment rate. If that does not happen the credit expires. In effect, the netted off amount is paid for at the normal consumption rate and the excess, if any, at the premium rate. If the credit expires there is no payment or return.

One variant of the net scheme is for the householder to draw electricity down for their use and to sell any excess to an electricity retailer, which is in effect the net scheme that the ATO refers to in its rulings. For the sake of completeness the paper will deal with the tax implications of these entire household 'feed-in' arrangements because they raise unresolved taxation issues. There are also hybrid arrangements where households can request that some of the payment be used to offset their other domestic bills that happen to be payable to the same company such as a charge for gas or other utilities.

Irrespective of whether the rate is subsidised or not an individual with solar panels on the roof of their private home will receive benefits from the electricity generated from their solar panels. This will often be a payment for the electricity generated or an offset of the notional amount to be received against household consumption or both. For example, if a gross payment is income then the same logic would seemingly apply to net payments. The only difference is the rate of the payment. The question then becomes what is the nature of the payment that is credited against private consumption, and of any credit left over which may or may not expire? The tax position is complicated even further when the electricity generated is used first for private consumption, namely fed into the household, and then only after that, it is fed into the grid. It is only the latter supply of electricity that is compensated by an actual payment or credit.

Before examining in detail the ATO's private rulings it is worthwhile to briefly look at what the situation is in the United Kingdom (UK) in relation to solar panel generated electricity and ask why did the UK government think it necessary to legislate in order to remove doubt from the question as to whether the payments are income and to further resolve any doubt by exempting that income? The UK has legislated to exempt returns from solar panel systems that provide for domestic and private use and allow some leeway for exporting some electricity to the grid. For example, in the UK subsection 782A(1) of the *Income Tax (Trading And Other Income) Act 2005* (UK) states that:

No liability to income tax arises in respect of income arising to an individual from the sale of electricity generated by a microgeneration system if–

- (a) the system is installed at or near domestic premises occupied by the individual, and
- (b) the individual intends that the amount of electricity generated by it will not significantly exceed the amount of electricity consumed in those premises.

A microgeneration system is one that produces up to 50 KW of electricity.²² . There is guidance from the Internal Revenue Service as to what 'significantly exceeds' means. They say that '...in general, a householder who does not intend to generate an amount of electricity more than 20 percent in excess of their own domestic needs is unlikely to be regarded as intending to

²² A 'microgeneration system' is defined in section 4, *Climate Change and Sustainable Energy Act 2006* (UK), and is currently determined to be up to 50 kW for electricity generation.

significantly exceed the amount of electricity consumed in their own premises.’²³ No such specific legislative guidance exists in Australia and so householders with solar panels must rely on the private rulings by the ATO. In the absence of a similar UK legislative provision in Australia, the main question raised in this paper is whether the return from the sale of electricity is assessable income, being income from property, or is the ATO correct in its treatment of these returns?

To help answer this question it is necessary to examine the ATO’s view of the various gross and net arrangements contained in a plethora of private rulings.

IV THE PRIVATE RULINGS

The ATO has issued a number of private rulings on the question of whether payments to householders for electricity generated by solar panels on their roofs, are income. Private rulings are just that: private in the sense that they are between the Commissioner and a particular taxpayer about their own tax affairs. They apply only to the applicant for the ruling and are used by an applicant who wants to know the Commissioner’s view of the tax law. A taxpayer who does not abide by the ruling may be subject to penalties for ignoring or not applying the ruling. Section 357-60 in Schedule 1 of the *Tax Administration Act 1953* (Cth), makes private rulings binding on the Commissioner in relation to a person to whom the ruling specifically applies and who also relies on the ruling. The Commissioner publishes a sanitised version of most private rulings to help other taxpayers gain some understanding of his views on the operation of the tax laws in particular circumstances. As the Commissioner makes clear on the Register of private binding rulings, and echoing the legislation, ‘the advice is binding on the Commissioner only in relation to the specific entity named in the written binding advice.’²⁴ That of course will not prevent other taxpayers relying on the general approach that they glean from the private rulings as a guide to their preferred tax outcome if the result is favourable and dismissing the ruling as not applying in general to them if its analysis is unfavourable. That is one reason why a public ruling which applies to all taxpayers is needed to provide certainty to those 2.5 million Australians living in households generating solar panel electricity or better still, an amendment to the *Income Tax Assessment Act* to exempt the returns from income tax.

A The private rulings in more depth

²³ HMRC, ‘BIM40520 - Specific receipts: domestic microgeneration: Income Tax exemption for domestic microgeneration’ <<http://www.hmrc.gov.uk/manuals/bimmanual/BIM40520.htm>>.

²⁴ The Commissioner of Taxation *Register of Private Binding Rulings Disclaimer* <http://www.ato.gov.au/rba/disclaimer.aspx>.

Most of the ATO's private rulings have decided that the amounts paid or credited are not income because they arise from private or domestic arrangements, or there is no intention to make a profit as no business is being conducted by the householder.²⁵ More recent private rulings support the two views. It would appear that the private rulings seem to be trapped in the 'not carrying on business and for private domestic consumption mode' for individual householders with solar panels on the roof of their homes. An alternative explanation and the one contended in this paper is that the payments and credits received are income from property and therefore do not require a profit making intention and are not dependent on the size of the operation and other indicia of a business.²⁶

Many of the private rulings that have decided the returns are not income relate to private households, some under gross feed-in schemes and others under net-feed-in schemes. Three common overlapping ATO themes emerge in these rulings. One is that 'the arrangement is private or domestic in nature.'²⁷ The second is that the householders are not carrying on a business of generating income from their solar panels. These two are related because a private or domestic arrangement is not a business arrangement. The third, a subset of the second, emphasises that there is 'no realistic prospect of a profit.'²⁸ Many refer to a combination of these as reasons for holding that the returns are not assessable income.

There appears to be a common approach in many of the private rulings. They start off by identifying the general characteristics of income identified by the courts. A number echo what is said in ATO Private Ruling Authorisation Number 101203003640. It says as follows:

In determining whether an amount is ordinary income, the courts have established the following principles:

²⁵ See, e.g., the following private rulings: Authorisation Number 1011733968747 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/1011733968747.htm>>; Authorisation number 1011677090553 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/1011677090553.htm>>; Authorisation Number 93762 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/93762.htm>>; Authorisation Number 92788 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/92788.htm>>; Authorisation Number 92719 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/92719.htm>>; Authorisation Number 92481 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/92481.htm>>; Authorisation Number 92225 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/92225.htm>>; Authorisation Number 90997 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/90997.htm>>; Authorisation Number 90089 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/90089.htm>>; Authorisation Number 90083 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/90083.htm>>; Authorisation Number 88668 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/88668.htm>>; Authorisation Number 83836 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/83836.htm>>; Authorisation Number 76255 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/76255.htm>>.

²⁶ We expand on this argument below..

²⁷ See, e.g., Authorisation Number 1011733968747 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/1011733968747.htm>>; Authorisation Number 76255 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/76255.htm>>.

²⁸ See, e.g., Authorisation Number 90083 <<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/90083.htm>>.

- what receipts ought to be treated as income must be determined in accordance with the ordinary concepts and usages of mankind, except in so far as a statute dictates otherwise
- whether the payment received is income depends upon a close examination of all relevant circumstances; and
- whether the payment received is income is an objective test.

Relevant factors in determining whether an amount is ordinary income include:

- whether the payment is the product of any employment, services rendered, or any business
- the quality or character of the payment in the hands of the recipient
- the form of the receipt, that is, whether it is received as a lump sum or periodically; and
- the motive of the person making the payment, but noting that this latter factor is rarely decisive, as a mix of motives may exist.²⁹

The ruling goes on to say, following decisions such as *Federal Commissioner of Taxation v Rowe*³⁰ and *Federal Commissioner of Taxation v Cooling*,³¹ that '[u]ltimately, whether or not a particular receipt is ordinary income depends on its character in the hands of the recipient. The whole of the circumstances must be considered.'³²

Traditional approaches highlight not just regularity and periodicity as one guide to income but also emphasise that the gain must be real, namely that it must be cash or convertible into cash. The underlying concept is that income flows from something else, or as Pitney J in the famous US case of *Eisner v Macomber* put it 'income may be defined as the gain derived from capital, from labour or from both combined.'³³ In other words, income flows from property, from labour, or a combination of both. His Honor goes on to describe income from property in the following terms:

Here we have the essential matter: not a gain accruing to capital, not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value, proceeding from the property, severed from the capital however invested or employed, and coming in, being 'derived', that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal; that is income derived from property. Nothing else answers the description.³⁴

²⁹ ATO, ATO Private Ruling Authorisation Number 101203003640

<<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/1012030036401.htm>>.

³⁰ (1997) 187 CLR 266.

³¹ (1990) FCR 42

³² Ibid.

³³ Pitney J, *Eisner v Macomber* 252 US 189 (1920) 206

³⁴ Ibid, 207.

Indeed, nothing else seems to answer the description of the payments or credits householders receive for electricity fed into the grid, other than income from property. Income is the fruit that grows from the tree.³⁵ The householder's receipts are fruit that grows from the tree of the solar panels.

Professor Parsons notes when discussing his Proposition 12³⁶, namely that a gain derived from property has the character of income that the principle is 'wide enough to embrace gains which are not simply returns to an owner who waits passively for his return from property.'³⁷ He goes on to say however that '[i]n general, gains within Proposition 12 will be passive gains, in the sense that there will be minimal effort by the taxpayer beyond the selection of an investment.'³⁸

Parsons goes on to explain that income from property will '... include gains to which the words "dividends", "interest", "rent" and "royalties" may be appropriate.'³⁹ Prompted by an obiter dicta comment by Chief Justice Barwick, he goes on to speculate however that the regular payments received in *Cliffs International Inc v Federal Commissioner of Taxation*⁴⁰ for the sale of shares in a company that owned a mine, with the payments by the buyer for the shares calculated by reference to the amount of ore taken from the mine and paid regularly over a period of time, may be income not just because of the regularity of receipts or as compensation receipts, but also that the receipts might be gains from property which would make them income.⁴¹ In other words, applying this logic to the present situation, returns from an investment in solar panels might also be income from property.

One point seems clear. For Parsons the only indicia of income from property is that a return flows from the property. There is no question of a profit making intention being relevant. Indeed Parsons restricts that profit making intention to business income.⁴² The ATO and the courts have accepted that in the case of rental properties which are one of the main generators of income from property, the income is income from property unless the activity clearly indicates that it is of such a scale that it becomes income from business.⁴³ Only in the latter case is profit making intention relevant.

³⁵ Pitney J, *Eisner v Macomber* 252 US 189 (1920) 206.

³⁶ Professor Parsons proposed 15 propositions that attempted to state the meaning of income in a practical sense rather than an abstract sense. R W Parsons, *Income Taxation in Australia: Principles of Income, Deductibility and Tax Accounting* (The Law Book Company 1985, Facsimile reproduction 2011) 25.

³⁷ *Ibid*, 88.

³⁸ *Ibid*.

³⁹ *Ibid*, 89.

⁴⁰ (1979) 142 CLR 140.

⁴¹ RW Parsons, above n 36, 89.

⁴² *Ibid*, 143.

⁴³ See for example ATO, Taxation Ruling TR 93/32 Income tax: rental property - division of net income or loss between co-owners <http://law.ato.gov.au/atolaw/view.htm?DocID=TXR/TR9332/NAT/ATO/00001>; see also TD 2006/31 Income tax: is a government rebate received by a rental property owner an assessable recoupment under subsection 20-20(3) of the Income Tax Assessment Act 1997, where the owner is not carrying on a property rental business and receives the rebate for the purchase of a depreciating asset (for example an energy saving

Some rulings recognise that the returns might be income from property, at least intellectually. Thus for example, ATO Private Ruling Authorisation Number 101203003640 says that 'a solar system is considered to be property and returns received in connection with it are potentially assessable income.'⁴⁴ Then it does something which appears to be rather odd. It says:

In determining whether or not the payments are assessable income the following are important:

- the size of the solar system and its generation capability
- the terms of the arrangement with the electricity retailer and in particular whether the solar system:
 - I. is configured into the electricity system of the home - the solar system first supplies electricity to the home to satisfy household electricity consumption before exporting excess electricity to the grid (referred to as a 'net' scheme), or
 - II. exports all electricity to the grid (referred to as a 'gross' scheme).
- the feed-in tariff payments and whether they are considered to represent a return on your investment in the solar system, and
- whether there is a realistic opportunity for you to profit from the arrangement, and the regularity of payments / credits received from the feed-in tariffs such that they can be relied upon.⁴⁵

It is unclear why size, consideration of return on investment and profit opportunity, whatever that means, are used to judge whether payments flowing from property are income. Property income is a classic example of the flow concept of income, namely the tree and fruit analogy referred to earlier.⁴⁶ Income flows from the property. Dividends flow from shares. Interest flows from the money deposited. Royalties flow from intellectual property. Rent flows from the ownership of the rental property. Payments or credits for electricity flow from the ownership of solar panels and the capital outlay necessary to install them.⁴⁷

Indeed the criteria set out above are some of the guides the courts and administrators use to determine if there is a business being carried on. Size and profit making intent are clearly indicia of a business. It is not appropriate to apply them to income from property and this has never been the case in Australia. Otherwise the ATO might be tempted to argue that in relation to negatively geared rental properties there is no intention and no likelihood of making a profit from the arrangement and so the returns are not income.

appliance) for use in the rental property

<<http://law.ato.gov.au/atolaw/view.htm?DocID=TXD/TD200631/NAT/ATO/00001>>.

⁴⁴ ATO, above n 29.

⁴⁵ Ibid.

⁴⁶ Pitney J, *Eisner v Macomber*, above n 30.

⁴⁷ It is assumed that the homeowner lives in the property on which the panels are installed. The situation with rental properties that have solar panels on the roof is not discussed in this paper.

The fact that the ATO does not raise the issue of profitability with negatively geared property investments but does so for solar panel payments suggests at least an ambiguity in the ATO's thinking and this inconsistency further supports the main contention in this paper that the returns from the solar panels are income. Moreover, there is an immediate need for a final resolution of the issue with a public ruling or possible amendment to the income tax legislation, perhaps similar to the UK approach.

In responding to concerns that negative gearing would be disallowed after the decision in *Fletcher & Ors v Federal Commissioner of Taxation*,⁴⁸ the ATO said, in TR 95/33, that the peculiar circumstances of that case, where any real gain would arise in the last five years of the 15 year arrangement and with the possibility and almost certain actuality of withdrawing from the arrangement before then, meant that the interest deduction was not related to the income earning activity and hence not allowable.⁴⁹ Thus at paragraph 46 the ATO says:

These kinds of features are not inherent in the usual kind of negatively geared investments. It is generally not the case in commonly encountered negative gearing arrangements that they are intended to, and are structured on the basis that they have a defined and pre-ordained period to run. Whilst certainly a consideration, the major advantage of such an arrangement is not usually the tax deductions available for interest outgoings. Accordingly, and in the usual case, a commonsense or practical weighing of all the factors could be expected to lead to the conclusion that the relevant interest expense is properly to be characterised as genuinely, and not colourably, incurred in gaining or producing assessable income or in carrying on a business for that purpose, and will fall entirely within either the first or second limbs of subsection 51(1).⁵⁰

Subjective intention in relation to deductions under what was the first limb of subsection 51(1), now section 8-1, ITAA 97, are not usually relevant in determining if the loss or outgoing is allowable, unless the circumstances show that the deductions will be greater than the receipts. This is certainly the case in the long term, and may be the case in the medium term too, when interest still outweighs rental income. As the Court said:

If, however, that consideration reveals that the disproportion between outgoing and relevant assessable income is essentially to be explained by reference to the independent pursuit of some other objective and that part only of the outgoing can be characterised by reference to the actual or expected production of assessable income, apportionment of the outgoing between the pursuit of assessable income and the pursuit of that other objective will be necessary.⁵¹

The point of this is to argue that in non-business circumstances subjective purpose is only relevant where the arrangement is out of the ordinary, such as in *Fletcher's* case where the

⁴⁸ 91 ATC 4950.

⁴⁹ ATO, Taxation Ruling TR 95/33 Income tax: subsection 51(1) - relevance of subjective purpose, motive or intention in determining the deductibility of losses and outgoings
<http://law.ato.gov.au/atolaw/view.htm?DocID=TXR/TR9533/NAT/ATO/00001&PiT=99991231235958>.

⁵⁰ Ibid.

⁵¹ Above n 48, 4958.

arrangement could and clearly would have ended the flow of income in the profitable years. If that is the case for non-business interest deductions in relation to income from property, then might it not also be the case that intent is irrelevant in determining whether returns from property are also income? Finally, on this point, it has proved to be highly improbable that there is any authority for the proposition that income from property requires a profit making intention rather than the fact of mere flow from the underlying property determining the income nature of the amount. Certainly Parsons appears to have thought so.

It is contended in this paper that the criteria for determining if there is income from property should be: 'does the return flow from the property?' When a taxpayer earns interest from money invested in say a term deposit that interest is assessable income because it flows from the money invested in the bank. The size of the deposit and intention to make a profit are irrelevant. A taxpayer could earn ten cents interest from ten dollars in a bank account and it will still be assessable income despite the small size of the deposit and payment and the fact that the taxpayer has no intention of making a profit. For example, the taxpayer's intention might be to simply preserve their capital. That does not render any subsequent gain non-assessable.

Some private rulings refer to the public ruling, IT 2167 on certain family and similar arrangements in relation to 'rent'.⁵² This is because in looking at the nature of the payments the ATO is looking for some indication that the activity is something more than private or domestic in nature. This is a further indication the ATO misunderstands the nature of income from property. Does it ask the same question in relation to rent, to dividends, to royalties or to interest? With one exception, and this is discussed below, the answer is no. Why then should it be relevant in relation to property income derived from solar panels on the roofs of householders throughout Australia?

The exception, as mentioned above, involves 'rental income' and is examined in the public ruling, IT 2167.⁵³ That ruling deals with among other things, 'rental income' in circumstances where there is some connection between the lessor and lessee and the rental payment is not at or even approaching a commercial rate of rent. It makes the point among a range of others that a payment by family members of an amount of money for board and lodgings is not assessable income. It also reflects on other family arrangements where a very low 'rent' is in fact payment for costs incurred in care. This happened in the case of *Federal Commissioner of Taxation v Groser*⁵⁴ where the 'rent' of \$2 per week was held to be a contribution to the funds out of which an invalid brother could be looked after.⁵⁵ In *Groser's* case⁵⁶ the Court held that \$2 'rent' paid by the taxpayer's family members was not income. It did not have a commercial reality to it to make the activity income producing. Having a commercial reality is not the same as having a

⁵² ATO, Taxation Ruling No. IT 2167 <<http://law.ato.gov.au/atolaw/view.htm?docid=ITR/IT2167/nat/ato/00001>>.

⁵³ Ibid.

⁵⁴ *FCT v Groser*, 82 ATC 4478.

⁵⁵ Ibid.

⁵⁶ Ibid,

profit making intention. By contrast, although there were family considerations in *Federal Commissioner of Taxation v Janmor Nominees Pty Ltd*,⁵⁷ the crucial point was that the rental arrangements were clearly commercial. They were on an arm's length basis. In *Madigan v Federal Commissioner of Taxation* a low non-commercial rent plus a private relationship between the two parties saw deductions claimed over and above the rent disallowed. On this basis it is difficult to understand how the public ruling, IT 2167, or the private rental benevolence principle, if one exists, has any relevance to payments made under contracts between two unrelated parties, namely the householder and electricity providers, at commercial rates or commercial rates plus government subsidies.

Another possible argument is that the payment represents 'a mere contribution to costs.' That appears in an indirect way to be the case in relation to electricity fed directly into the home, a net scheme in ATO terminology thus saving the householder some electricity costs associated with running their home. It is contended in this paper, and supported by a number of cases such as *Tenant v Smith*⁵⁸ and *Federal Commissioner of Taxation v Cooke and Sherden*⁵⁹, that such a saving in expenditure is not income. It has not 'come in' to the taxpayer. The saving is also arguably not convertible into money or money's worth. It is not derived by the householder. The mutuality principle also applies. One cannot earn income from oneself.⁶⁰ There has been no gain to the householder.⁶¹ The saving in expenditure is thus not assessable income.

This outcome does not arise where the electricity provider makes a full payment under a gross scheme in ATO terminology for all electricity relayed to the grid. The householder can then use the payment to cover domestic costs including, for example, electricity. This is not a situation similar to 'a mere contribution to costs.' It is the payment of income which the householder can then use for any purpose including paying household bills. It is not an amount specified to be used against a specific cost or offset against that cost. Further, to reiterate the points above, the cost is not a 'mere cost'; it is a bill paid at commercial rates, and secondly the payer stands at arm's length from the householder.

If an amount under a gross scheme is not paid to householder but offset against domestic consumption then it is contended in this paper that the amount of the credit is a constructive receipt by the householder of the payment and so is income according to ordinary concepts. The offsetting or credit has arisen under a contract entered into by the householder which sees them direct the electricity company to offset the return from the solar panels against the current electricity bill. This is both the constructive receipt concept found in the income according to ordinary concepts sense and also as set out in subsection 6 – 5(4) of ITAA 97.

⁵⁷ 87 ATC 4813.

⁵⁸ [1892] AC 150.

⁵⁹ 80 ATC 414.

⁶⁰ *Bohemians Club v Acting FCT* (1918) 24 CLR 334, per Griffith CJ at 337.

⁶¹ *Hochstrasser v Mayes* [1960] AC 376, per Lord Denning.

B Private or domestic or carrying on a business?

The ATO private rulings in which the decision has been made that the payments are not income because they arise under private or domestic arrangements that involve situations where the household first draws on its own solar panel generated electricity to satisfy its immediate consumption needs before exporting the excess into the electricity grid. According to the ATO, the configuration of the solar panel system ‘into the electricity system of the home’⁶² is one consideration in determining if the payments are private or domestic in nature. In our view this is one very important distinction. We agree, for the reasons outlined above, that such a configuration, by saving domestic expenditure, cannot itself be income. It has not been derived. It is not income – it does not come in. It is not money or money’s worth.

In some private rulings the ATO has ruled that because the electricity is fed into the commercial grid then the arrangement is not private or domestic. For example in Private Ruling Number 1011747919538 the ATO said:

The arrangement is not of a private or domestic nature because the solar system does not provide electricity to your private residence. Instead, all electricity produced is exported back to the grid. You then buy back electricity to meet your own electricity needs.⁶³

This would appear to be an attempt to recognise that such payments may in fact be income, but without explaining the reasons why. Often, even when the electricity is fed into the grid, the ATO uses the ‘private and domestic’ or ‘not carrying on a business’ rationale to argue the payments are not income. It ignores the possibility of this being income from property.

The ATO position has varied over time, reflecting the confusion the ATO has about the nature of the payments. Thus, in another private ruling where a farmer put panels on a building on their farm under a gross feed-in tariff scheme under which all the electricity generated was fed into the grid the ATO held that the payments were income because, among other things, a business of primary production was being carried on. It said:

Under the feed-in tariff scheme and as described in your ruling application, the electricity company credits or pays a premium feed-in tariff to the electricity account holder for all electricity generated and contributed to the electricity grid. The electricity account holder then buys back electricity from the company according to their consumption. Payment for the electricity generated is separate and not related to the amount of electricity consumed. The rate

⁶² ATO, ATO Private Ruling Authorisation Number 101203003640
<<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/1012030036401.htm>>.

⁶³ ATO, Private Ruling Authorisation Number: 1011747919538 21 August 2011
<<http://www.ato.gov.au/corporate/content.aspx?doc=/rba/content/1011747919538.htm>>.

paid by the electricity account holder for electricity consumed is the same as that available to any other electricity account holder.⁶⁴

The ATO listed its reasons for doing so, which apart from the fact that it was installed on a business property; seem to apply to household solar panels too. It said:

Having regard to all of the facts, it is considered that your solar system installation amounts to an arrangement which is not private or domestic in nature because:

- i. The solar system will be installed on a property which is currently used to derive assessable income.
- ii. The electricity retailer will pay a premium feed in tariff per kilowatt hour for any excess electricity that you generate.
- iii. The arrangement is commercial in nature; an agreement has been created.
- iv. There is a realistic opportunity to profit from the arrangement even if no profit is actually made in any particular period.⁶⁵

In a further ruling the ATO did not use the household and commercial grid difference to determine that the arrangements were private or domestic. They used size. In Private Ruling Number 1012030036401 the ATO said:

The scheme is of a private or domestic nature. The size and scale of the system installed and the arrangement with the electricity retailer indicate there is connection of the scheme with the electricity needs of your household.⁶⁶

By this the ATO meant that the 'size of the solar system ... installed is essentially designed principally for ordinary domestic needs and will generate an amount of electricity suitable for household need.'⁶⁷ This was a gross feed-in tariff system, so all the electricity generated was fed into the commercial provider's grid and the householder was paid for that. It is difficult to understand how in those circumstances the scheme has any connection with the electricity needs of the household. Secondly, even if there is a link, what difference does that make in determining whether the receipt is assessable or not? Earning returns to pay for necessities does not make the income private or domestic and thus non-assessable. For example, people on the minimum wage earn just enough to live fairly basically but this does not make their wage a private or domestic payment even though clearly there is a linkage between the wage and the needs of their household.

⁶⁴ ATO, 'ATO Private Ruling Authorisation Number: 1011837750318' 12 August 2011 <<https://www.ato.gov.au/rba/content/?ffi=/misc/rba/content/1011837750318.htm>>.

⁶⁵ Ibid.

⁶⁶ ATO, 'ATO Private Ruling Authorisation Number: 1012030036401' 15 December 2011 <<https://www.ato.gov.au/rba/content/?ffi=/misc/rba/content/1012030036401.htm>>.

⁶⁷ Ibid.

Another argument is that the householders are not carrying on a business. The ATO then concludes that this means the payments are not income. The two do not necessarily follow. A taxpayer is not carrying on a business by earning wages yet the wages are clearly assessable income. By failing to adequately address the question of income from property and sometimes conflating it with income from business, the ATO has failed to address the real question. Are the returns on investment in solar panels income from property and on the basis of a standard analysis of the existing taxation law, the returns are as a consequence, assessable income? The above analysis provides the very clear answer to that question and the answer would appear to be: yes.

VI APPLICATION OF THE LAW TO THE 'RETURNS'

There is no express statutory provision which includes the return derived from solar panel electricity generation in assessable income so it is not statutory income under s 6-10 of the *Income Tax Assessment Act 1997* (Cth), (ITAA 97). This leaves the other option open: namely are the returns ordinary income pursuant to section 6-5(1) of the ITAA97? Ordinary income means income according to ordinary concepts, which despite its name means income that the judges have decided is income. Income is what 'comes in.'⁶⁸ It covers the usual categories such as wages and salary; namely income from labour and rent, dividends, interest, royalties being income from property or a combination of both; namely income from business.

This means that taxpayers and tax advisers have to rely on court pronouncements about what is ordinary income and the guides or indicia that they have provided over the years for determining if an amount is ordinary income. Echoing the earlier comments in this paper about the three broad categories of income, the ATO Private Ruling 92788 correctly notes that:

Ordinary income has generally been held to include three categories, namely, income from rendering personal service, income from property and income from carrying on a business.

The ATO goes on to say that because there are no statutory provisions making the returns income, "...it is only necessary to consider if the payments or credits returns should be included as 'ordinary income'." That is true. But then the ATO completely ignores the income from property category in its analysis and says: 'They will be ordinary income if you are carrying on a business of generating electricity.' While technically true, even if the payments are not business income they still need to be considered as income from property, something the ATO does not address.⁶⁹

⁶⁸ *Scott v CT (NSW)* (1935) 35 SR 215; *Tennant v Smith* [1892] AC 150, per Lord McNaghten at 164; *FCT v Cooke & Sherden* (1980) 10 ATR 696 at 703.

⁶⁹ It is readily accepted that the payments are not income from personal services or labour.

But even on the ATO's own terms of 'are you carrying on a business?' there are interpretative refinements that the ATO seems to have glossed over. ATO Private Ruling 92788 spells out the judicial indicators for testing the presence of a business: intention, prospects of profit, a commercial approach, repetition and regularity, organisation in a business-like manner, size and scale of the activity and so on.⁷⁰ The ATO in their private rulings appear to completely misread the above indicators since the prospects of profit with electricity generated from solar panels is often quite immediate and stretching over many years although the ATO appears to think that a more likely scenario is one where no profit is generated by the taxpayer. None of these indicia of business income are necessarily determinative of whether a business is being carried on.⁷¹ Indeed, the High Court in the case of *Federal Commissioner of Taxation v Stone*⁷² held that a javelin thrower was carrying on a business despite the fact the taxpayer did not have an intention to make a profit. The other indicia were sufficient to conclude this was an activity that could be characterised as carrying on a business.

For an ordinary taxpayer with solar panels on the roof of their home, the ATO concludes that they are not carrying on a business of generating electricity. This is because their intention is evidently to benefit the environment, not to make a profit. Of course a taxpayer can have a number of purposes in undertaking an activity and for many people who install solar panels on their roofs the return they are to receive is an important consideration in undertaking the investment. After all, the whole point about the government subsidies is to make it profitable for households to install solar panels and generate electricity. Some estimates are that depending on which State or Territory scheme under which the payments are made to the householder, the investment can be recouped in less than 5 years. Those considerations may indicate a possible intention to make a profit. Again, that is dependent on the individual circumstances of each householder in receipt of returns, and many may say that in their altruism they want to reduce greenhouse gas emissions or that in order to be economical they want to save themselves money on their electricity bill, or both. Alternatively, they may argue this is in the nature of a hobby, much like amateur footballers being paid a hundred dollars per game as part of recouping costs or a hobby.

If it is accepted for the purposes of discussion that there is no profit making intention as noted above that does not mean there is no business being carried on by the homeowner. However, if it is further agreed that in the solar panel situation the ATO is correct and the householder is not carrying on the business of electricity generation why does that determine that the amounts are not income?

The ATO conclusion that because the householders are not carrying on a business, therefore the payment or credit is not income is open to question. As pointed out above, it does not determine the issue because the analysis only addresses one of the categories of income. The main

⁷⁰ *Ferguson v FCT* (1979) 9 ATR 873.

⁷¹ *Ibid.*

⁷² *FCT v Stone* 2005 ATC 4234

contention in this paper is the ATO private rulings are wrong. Arguably the returns from household rooftop solar panel generated electricity are not business income. It is also clearly not income from personal services. But why is the solar panel generated electricity payment or credit not income from property? Why did the ATO not address this issue?

A Tax Loss and Negative gearing as an Explanation for the ATO's View

It is contended in this paper that the answer may lie in the deduction issues that the ATO dealt with, for example, in the ATO Private Rulings 92225 and 92788. Because the payments are in the eyes of the ATO not income, it means that under basic tax principles there are no deductions to be claimed by the householder in gaining or producing assessable income; there is no assessable income. For solar panels, the two main deductions would be interest on money borrowed to pay for the panels and the decline in value of the panels as they depreciate. In those circumstances it is possible that a taxpayer could be negatively geared. This just means that the deductions are greater than the income and that the tax loss is then able to be offset against other income such as a salary or wage. However, because on the ATO's view there is no assessable income there can be no corresponding deductions. The tax loss and negative gearing problem is thus defined away.

At the heart of the private rulings is the idea that the lack of a profit making intention removes these amounts from the realm of assessable income. Yet if one looked at the history of the ATO's treatment of negatively geared investment properties it is clear that an intention to make a profit is not relevant or determinative when discussing property income. If it were then the Commissioner would be rejecting rent on negatively geared properties as assessable income and hence disallowing interest and capital allowance deductions. Certainly the argument that the property investor has no intention to make a profit and the investor is not carrying on a business applies as equally to such properties as it does to solar panels: that is, not at all.

B Income from property as a flow

The concept of income as a flow seems clear in the context of income from property. Rent flows from the rental property. Dividends flow from the ownership of shares. Interest flows from the principal sum invested. Royalties flow from the use of copyright or intellectual property. Income payments flow from the solar panels. It is the tree of property, of a capital asset, which produces the fruit of income. As discussed earlier, the idea of a profit making intention is alien in this context. Indeed, the indicia of business, of which profit making intention is one subset, are completely foreign in this context. The question of intention, of size and scale, of organisation, of a business-like manner, of regularity, do not determine the income character of a flow from property. The flow itself does. Is there property from which a payment, to use a neutral term,

flows? If the answer is yes, then the payment is income per se. It flows from the property therefore it is income.

In the case of household rooftop solar panel generated returns, there is clearly property from which that payments flows. It is the solar panels. That leads inexorably to the conclusion that the payments are income according to ordinary concepts. If that is not the case then rent, interest, dividends and royalties could not be characterised per se as income because the necessary profit making intention, for example, may be absent. While the ATO may have been tempted in the past to run such an argument in relation to negatively geared rental properties, the Commissioner quickly resiled from that position. The ATO's position is now well settled.⁷³ In addition the ATO document 'Rental Properties 2010' brooks no argument. Rent is assessable income. It then lists a range of deductions including interest on a loan to purchase the rental property as deductible. This is so whether or not the property is negatively or positively geared. By analogy, payments arising from solar panels are also income from property. Rent is the payment for the use of the other party's real or personal property. So while these solar panel payments are not rent, they are arguably akin to rent or interest. The householder is obtaining a return from their investment. The returns are assessable income against which various deductions, including interest and decline in value, are deductible.

C Income from property category

This foray into specific examples of income from property is an attempt to raise a wider issue. That wider issue is that in order for an amount to constitute 'income from property', does the money or money's worth have to fall within the recognised categories of interest, rent, dividends, royalties and annuities? It is argued in this paper that the answer is no. It is true that subsection 6(1) of the ITAA 36 defines income from property to mean 'all income not being income from personal exertion'. The same subsection defines income from personal exertion to mean 'income consisting of earnings, salary, wages...in the capacity of an employee or for services rendered...and the proceeds of any business...but does not include (a) interest....or (b) rent, dividends or non-share dividends.' This is not of much help since the purpose of these provisions was to identify circumstances in which higher tax rates would apply to unearned or passive income.

Solar panel returns to residential home owners do not fall within the definition of personal exertion income. They are therefore payments from property and as has been argued above they are income. The references to interest, rent and dividends and specific examples of income from property are not exclusive. For example, there is no reference to royalties. So having come a full circle, it is contended that the solar panel returns are ordinary income because they flow from property. They are income from property. Throughout this paper reference has been made to the

⁷³ TR 95/33, above n 49.

returns received by households for electricity generated by rooftop solar panels. This part of the paper will examine the process by which households are either paid for the surplus electricity or provided with a credit and the basis for holding that both returns are income from property.

D Gross and Net Returns as Assessable Income

In some States and Territories many existing contracts were based on the fact that all electricity generated from household solar panels flowed into the grid and the householder received a payment for all of the electricity generated. By way of illustration as to how this works in practice, assume that in any one payment period the household in question has \$100 worth of private household electricity consumption and its solar panels generate \$250 worth of electricity into the grid. That \$250 is paid to the single owner of the house who then uses it to pay the family bills, including the electricity bill. On the basis of the above analysis of the taxation law, these types of payments are income from property and the \$250 is assessable income in the hands of the recipient. This conclusion is true for both industry gross feed-in schemes and tax gross feed-in schemes.

The situation becomes more interesting when there are industry and tax net feed-in schemes. Does an industry net feed-in scheme, where the electricity is used for private consumption and only the excess is exported to the grid, generate assessable income on the above analysis of the taxation law? The question really covers two different situations. The first is the use of the electricity for private or domestic purposes and the second is the excess if any electricity that is fed into the grid and being paid for or a credit being provided. That electricity that is used directly for domestic purposes does not create a payment or credit. In these circumstances there is no income: nothing has come in. Saving expenditure is not income.

If a householder has a vegetable patch in their backyard then the vegetables they eat is not income. It may save them money that they would otherwise spend on vegetables from a shop, but that is not the same as them being paid for their produce. There is also clearly no constructive receipt here, either within the concept of ordinary income itself or in terms of subsection 6-5(4) of ITAA 1997.

What about any returns for the excess electricity generated by the homeowner that is fed into the grid? This is more problematic. In TR 97/17 'Income tax: am I carrying on a business of primary production?'⁷⁴ the ATO uses the example at paragraph 88 of Norm who grows prize winning broccoli and pumpkins. He gives most of his produce away to friends and relatives but also sells a small amount of produce at various shows where he wins prizes. The ATO accepts that in those circumstances this is not a business but a hobby and the returns are not income.⁷⁵ However,

⁷⁴ Australian Taxation Office, 'Taxation Ruling, TR 97/11, Income tax: am I carrying on a business of primary production?' < <http://law.ato.gov.au/atolaw/view.htm?DocID=TXR/TR9711/NAT/ATO/00001>> paragraph 88.

⁷⁵ Ibid, paragraph 89.

because there is ongoing labour from Norm and capital such as seeds, plants and land are involved in growing the vegetables, why is it not appropriate to argue that these occasional returns are in fact income from a business since business is the combination of labour and capital? They are not, because, among other things, the scale of the venture is small and Norm has no profit-making intention.⁷⁶

However, these are not relevant considerations for any excess electricity fed into the grid from which a receipt arises. There is not a combination of ongoing labour and capital. The returns arise from the solar panels, from property. There is no labour or human intervention involved other than in the original installation and ongoing maintenance. Like a rental property, the solar panel generated returns, if they arise, flow from property and the questions of scale and profit making intention are not relevant. It is the flow itself that is the determinative key to defining the nature of the returns as income. Where credits do not become available to the householder because they are not used within say 12 months, they expire, they have not been derived by the householder and so are not income. Where there are credits for the excess fed in to the grid, rather than direct payments, and they are used to offset say an electricity or other bill from the provider, then it is contended that such amounts are constructively received, either under the common law concept of constructive receipt that arguably remains in the ordinary meaning of income and definitely under the specific provision found in subsection 6-5(4). That provision says that in working out if and when you derived ordinary income, you are taken to have received the amount as soon as it is applied or dealt with in any way on your behalf or as you direct.

In these circumstances all the electricity that the solar panels generate is fed into the grid. The whole amount may be paid, or some may be offset against the domestic electricity bill and the remainder paid to the householder. In some cases some may be offset against the domestic electricity bill and the rest credited for future offset within a specified time. For the same reasons as argued above, full payment for all electricity generated is assessable income, being income from property. Credit against the household electricity bill with the rest paid to the householder are both returns which should be included in assessable income. Where the credit is time dependent, that part of it which expires, i.e. does not come into the householder, is not included in assessable income. It is not derived by the taxpayer.

In Victoria, for example, it is up to the electricity energy providers to determine the best way of paying household solar panel electricity suppliers. Indeed, the Department of Primary Industries website indicates that the Solicitor-General's advice is that requiring direct payments by electricity companies to householders without more could be an 'excise' payment and may be unconstitutional since under section 90 of the Constitution only the Commonwealth government can impose excise taxes.⁷⁷ The result is that electricity companies under the Victorian scheme

⁷⁶ Ibid.

⁷⁷ Department of Primary Industry, Victoria, *Premium Rate for Solar Power* <http://solarlink.net.au/vic_fit.pdf>.

may offer direct payments or credits. The surplus, if there is any, is either paid to the occupiers or it is set aside as a credit against future household electricity bills. In some cases the credits, if unused after 12 months, expire. These credits raise two issues such as the receipt and derivation of income and the convertibility of the credit into money.

In the example used above, assume first that instead of being paid \$250 the householder is paid \$150 and the other \$100 is offset against their private electricity consumption liability from the same company. Has the householder received that \$100? Income has to be derived by the taxpayer to be assessable in their hands. For example section 6-5(1) of ITAA 97 says that for Australian residents, which the people in most households in receipt of solar panel payments will be for tax purposes, your assessable income is ordinary income i.e. income according to ordinary concepts that you derived: namely ... Income is what comes in to the taxpayer.⁷⁸

Often, but not always, derivation is actual receipt. While that may be true for cash accounting taxpayers, it is not the case for accrual accounting taxpayers. Accrual accounting is really receipt in anticipation. But for cash accounting taxpayers, as individuals with solar panels on their roofs will be, the question is still valid. Does something which 'pays a householder's bills come in to them'? Has the householder derived income when all that appears to have happened is that they have been saved expenditure? It seems clear that householders who have entered into contracts with electricity companies to divert some of their solar panel income to pay for their household electricity bills are effectively in receipt of that money. Section 6-5 (4) of ITAA 97 legislates the concept of constructive receipt when it says that in working out if and when you derived ordinary income, you are taken to have received the amount as soon as it is applied or dealt with in any way on your behalf or as you direct. The householder has constructively received the amount and merely bypassed physical receipt by entering into the contract and directing the electricity company to offset an amount against their electricity bill. This is so even though the contract has been developed by the electricity company and that the condition of offsetting solar panel payments against electricity bills is in one sense imposed on the householder. They are entering into the contract with free will. They are, as a consequence, telling the electricity company to use part of the overall payment to pay their bill. In other words, they are agreeing to constructively receive the bill amount. In any event the amount is being dealt with on the householder's behalf. Section 6-5 (4) applies. In this example this means the householder has constructively received the \$100 offset against their private electricity bill and so it, together with the direct payment of \$150, will be assessable income. In total \$250 is assessable income.

Turning to the credit situation, the following example illustrates the way in which the householder is rewarded for the surplus electricity. Using the \$250 worth of electricity generated and \$100 of private electricity consumption, it is assumed that the scheme allows only for the offsetting of any income against private electricity consumption. The remaining amount is

⁷⁸ Scott v CT (NSW) (1935) 35 SR 215; Tennant v Smith [1892] AC 150, per Lord Mcnaghten at 164; FCT v Cooke & Sherden (1980) 10 ATR 696 at 703. As Darley CJ put it in *Liquidator North Sydney Investment and Tramway Co v CT (NSW)* 1898 15 WN (NSW) 82 'My income is what actually comes in to me...'

carried over until the next payment period. In the example assume that the periods in question are monthly and the figures remain the same each month. The householder receives a private electricity bill of \$100 and the solar panel electricity generated amounted to \$250. In July the householder is in constructive receipt of \$100 of assessable income, with an amount of \$150, which is not yet income because it has not yet been derived, is rolled over to August. In August the householder constructively receives \$100 of assessable income and rolls over \$200 to September. This will go on for the whole income year so that by the end of June the householder will have constructively received \$1,200 solar panel income and have rolled over a total accumulated offsetting amount over the year of \$1,800.

If the electricity company cashes out this accumulated offset and pays it to the householder, it is derived at the time of receipt by the householder. If under the contract the accumulated offset is extinguished if not used within say the income year, then that voided offset is not income because it has never been derived by the householder.

What about those situations where no bill arises in the first place because the electricity is fed into the house whenever an appliance is on, and it is only the excess above home consumption that is fed into the grid for sale to the electricity company? If it feeds into the household electricity system then that might indicate the system is for domestic or private purposes and hence is not, as the ATO contends in their private rulings, assessable income. Derivation issues therefore, never need addressing. This argument is correct at least in relation to the 'saved' expenditure but not to the amounts fed into the electricity company's grid. The fact that some of the electricity is fed back into the household first to cover domestic use determines the non-income nature of that amount, or notional amount, but does not determine the income nature of the payment for the electricity sold to the electricity company through the process of it being fed into their grid. In other words, the direct use of the system to power the electric devices in the household means there is no electricity bill and no amount to offset out of the payments made for the electricity fed into the electricity company's grid. The electricity that powers the household directly is not convertible into money. It is not derived. You cannot earn income from yourself.

If a taxpayer has a backyard garden that produces food for the family's personal consumption then the value attached to the produce is not income for a range of reasons. As explained before, nothing has been derived. You cannot earn income from yourself. The amounts are not money or money's worth. If, however, they sell the surplus produce to a local food retailer at commercial rates under a commercial contract and receive regular, even if small payments from them, then the payments will be assessable income. This income by analogy argument is further bolstered by the fact that a private garden is less 'commercial' than spending thousands of dollars to put solar panels on a roof and enter into a contract with an electricity supplier to be paid for surplus electricity that has been generated. In other words, using this example, the electricity bill of \$100 never arises because the solar panels provide the household with all the electricity they need for their own domestic uses. The remaining \$150 is exported to the electricity company grid and if it is paid to the householder becomes income in their hands.

VII CONCLUSION

It is contended in this paper that payments for household solar panel generated electricity and consequent credits against household consumption are income from property and are hence assessable income. If the credits expire they are not derived and hence not assessable income in the hands of the householder. If the electricity is first fed into the household to meet its domestic needs that saving is not income but any amount exported to the electricity company grid is assessable income if the electricity company pays the householder for it or gives a credit for it which is actually used to offset other bills.

These conclusions differ markedly from the private rulings of the ATO on this issue and will, if correct, impact one million households with 2.5 million Australians living in them. The ATO should rectify this great uncertainty by researching the issue fully and releasing a public ruling on the issue or have the government amend the ITAA 97. That would take some time and would produce ramifications for the solar panel market and for households considering purchasing solar panels. For those households already using solar generated electricity it would change the basis of their calculations used for purchasing solar panels. Further, if the ATO were to follow the arguments adopted in this paper the result would be uproar from both the industry and the one million households who have assumed that their returns are not taxable. For that reason the paper strongly suggests that the government consider legislative intervention urgently to resolve the situation one way or the other.