CARISMA SOLUTIONS

Income Averaging for Musicians

A Trainer's Deck

Division 405 of the Income Tax Assessment Act 1997

Industry application : Performers, composers, recording artists, production associates

Prepared for
Carisma Solutions Trainer Programme

Confidential

Session Objectives

What you should be able to do by the end of this session

- Identify which musician clients qualify under Division 405 of ITAA 1997 and the three relevant categories of "special professional".
- Distinguish what counts as Taxable Professional Income (TPI) from non-TPI for a musician across performance, recording, and composition income streams.
- Apply the $2,500 threshold and identify the FIRST qualifying year for any new musician client.
- Perform the AASPI calculation for a musician and quantify the averaging benefit.
- Apply the correct ORDER OF OPERATIONS on foreign tour income (averaging BEFORE FITO).
- Recognise the top 5 errors that surface in musician files during review.
- Communicate the averaging benefit and limitations clearly to a musician client.

Agenda

Half-day classroom format

Part 1: Foundations

- Why averaging exists for musicians
- Division 405 overview
- Music industry context
- Industry bodies and source documents

Part 2: Eligibility and TPI

- Who qualifies as a special professional
- $2,500 threshold and first-year rule
- Edge cases
- TPI versus non-TPI income streams

Part 3: Calculation and worked examples

- The AASPI mechanism
- Example 1: Breakthrough album
- Example 2: Sync windfall
- Example 3: International tour and FITO
- Example 4: Publishing advance

Part 4: Review and close

- Top 5 errors in musician files
- Group discussion
- Reviewer mindset and key takeaways

Why Averaging Exists for Musicians

The income bunching problem

The Problem

- A musician may earn modestly for years, then receive a large royalty, sync fee, or commission in one year.
- A breakthrough album, an advertising sync, an international tour, or a publishing advance can produce a 5x or 10x income spike.
- Without smoothing, the entire spike is taxed at top marginal rates in the receipt year.
- The musician pays materially more tax than someone earning the same total income evenly.
- The spike year often reflects work performed across many prior years.

The Statutory Solution

- Division 405 of ITAA 1997 introduces the above-average special professional income (AASPI) mechanism.
- Only the portion of current year TPI EXCEEDING the four-year average is averaged.
- The AASPI is notionally taxed as if spread over five years (comparison-rate methodology).
- Division 405 is ONE-WAY: an offset in high years; no complementary tax in low years.
- Applies automatically once eligibility is met. Not an opt-in scheme.

The Music Income Volatility Patterns

Four scenarios that drive averaging benefits

Typical client patterns you will see

The breakthrough album

Modest baseline for years, then a major release with touring + royalties + publishing deal in one year.

The sync windfall

Stable performer income disrupted by a one-off licence fee from advertising or film.

The international tour

Australian-resident artist undertakes a multi-country tour; large foreign-sourced TPI in one year.

The publishing advance

Multi-year advance assessable on receipt; subsequent royalties recoup but do not change derivation year.

Industry Bodies on Source Documents

What each one issues and why it matters

Body	Role	Document you receive
APRA AMCOS	Collects performance + mechanical royalties for songwriters and publishers	Quarterly royalty statements by use and territory
PPCA	Collects neighbouring rights royalties for performers and labels	Annual distribution statements
ARIA	Charts, awards, certification (NOT a collecting society)	No income; possible taxable benefits
Distributors (Tunecore, DistroKid, AWAL, CD Baby)	Aggregate streaming revenue from DSPs	Periodic statements by platform + release
Music agents and managers	Negotiate engagements; take 10 to 20 per cent commission	Invoices for commission deducted from gross fees

PRACTICAL TIP: Always request APRA AMCOS and PPCA statements direct from the client portal. Emailed statements are frequently lost or partial.

Who Qualifies as a Special Professional

Three of the s 405-25 categories apply to musicians

Performing Artist

s 405-25(3)

An individual who performs or appears in a performance before an audience. Includes singers, instrumentalists, conductors, band members, session players, orchestral musicians.

Author

s 405-25(2)

An individual who is the author of a literary, dramatic, musical, or artistic work. Includes composers, songwriters, lyricists, arrangers of original works.

Production Associate

s 405-25(4)

An individual who provides artistic support to a performance or to the production of a sound recording. Includes record producers, music directors, artistic engineers.

A single musician client often falls into more than one category at once. A singer-songwriter who also produces records may qualify under all three. You do not need to apportion: any TPI dollar from a qualifying activity is in scope.

The $2,500 Threshold and the First-Year Rule

Two simple rules with significant consequences if missed

$2,500

TPI threshold for eligibility

s 405-30 ITAA 1997

If TPI falls below $2,500 in a year, the client is not a special professional for that year. The year is treated as a zero in the four-year average. Below-threshold years before the first qualifying year do not enter the calculation.

REVIEWER TRAP

Identify the FIRST qualifying year

- The first year the client reached $2,500 of TPI is the base year for all subsequent averaging.
- If you treat the year you START preparing for the client as their first year, all subsequent calculations are wrong.
- Interview the client about their full music career history, even if you have only seen the last two or three returns.
- Document the first-year identification on the workpaper cover.
- Amend prior returns only within the s 170 ITAA 1936 amendment period (typically 2 or 4 years).

Edge Cases: Who Is In and Who Is Out

Spot the boundary cases before the ATO does

Scenario	Division 405?	Why
Private music teacher only	**No**	Teaching is not performing, authoring, or producing
Music teacher who also gigs weekends	**Yes (gig income only)**	Gig income qualifies; teaching is non-TPI
Songwriter with no live performance	**Yes**	Authorship of musical works qualifies (s 405-25(2))
DJ in a nightclub or wedding	**Yes**	Live DJ sets are performances before an audience
Music critic / journalist	**No**	Not an author of musical works; not a performer
Recording engineer (purely technical)	**Usually no**	s 405-25(4) requires an artistic contribution
Recording engineer who also produces	**Usually yes**	Producing involves shaping the artistic outcome
Session musician on salary	**Yes**	Salary mode of payment does not change activity character
Music therapist	**No**	Allied health classification; not a qualifying activity

What IS Taxable Professional Income

Income streams that count toward TPI for a musician

Live Performance

- Touring fees and headline guarantees
- Concert door-share arrangements
- Festival appearance fees
- Corporate and private event fees
- Session player fees
- Conducting fees

Recording & Royalties

- Mechanical royalties (APRA AMCOS)
- Streaming royalties (DSP)
- Performance royalties (radio, TV)
- Neighbouring rights (PPCA)
- Producer points on recordings
- Master use licensing

Composition & Other

- Synchronisation licence fees
- Sheet music + folio royalties
- Commissioning fees
- Publishing advances (on receipt)
- Endorsements (where conditional)
- Most creative grants and prizes

What is NOT TPI

Apportionment is the norm: almost no musician return is 100 per cent TPI

Income stream	Why excluded
Private music tuition (studio teaching)	Not a qualifying activity under s 405-25
Music journalism, criticism, reviewing	Not author of musical works; not performer
Capital gain on sale of instruments	Statutory exclusion under s 405-20
Capital gain on sale of music catalogue (where capital)	Capital, not income (watch character of receipt)
Salary as a music administrator	Administrative role, not performing or producing
Investment income (interest, dividends, rent)	Not derived from qualifying activity
Government support payments (JobKeeper, etc.)	Government support, not from qualifying activity
Workers compensation and personal injury payouts	Compensation, not from qualifying activity

WORKPAPER RULE: Your workpaper must show: total assessable income MINUS non-TPI items EQUALS TPI used in AASPI calc.

The AASPI Mechanism

How the averaging benefit is calculated

Average TPI

```
=  (Sum of prior four years' TPI)  /  4
```

AASPI

```
=  max( 0 ,  Current Year TPI  minus  Average TPI )
```

Three points of nuance

- If average TPI exceeds current year TPI, AASPI is zero. Division 405 has no complementary tax. You do not get a top-up benefit in a low year.
- In the first four eligible years, the average is phased in. Year 1 uses an assumed zero average; subsequent years use available prior qualifying years.
- Below-threshold years before the first qualifying year do NOT enter the average. They are treated as zero.
- Once AASPI is computed, the tax saving arises from the comparison-rate calculation: tax on AASPI as if spread over five years.

Worked Example 1: The Breakthrough Album

Aria: singer-songwriter; Y6 album release, national tour, sync, publishing advance

Year	Description	TPI
Y1	EP release, regional gigs	$18,000
Y2	First album, modest touring	$32,000
Y3	Touring, first sync deal	$41,000
Y4	Festival circuit, side projects	$38,000
Y5	Pre-release touring + recording	$45,000
Y6 (current)	**Album release, tour, sync, advance**	**$285,000**

Calculation

Average TPI =

```
(32,000 + 41,000 + 38,000 + 45,000) / 4
```

= $39,000

AASPI =

```
max( 0 , 285,000 - 39,000 )
```

= $246,000

Illustrative tax effect

Standard tax on $289,000:
~ $94,500
Tax with averaging applied:
~ $73,200
Averaging benefit:
~ $21,300

Worked Example 2: The Sync Windfall

Devon: stable session musician; Y5 sync placement of a Y2 co-write

Year	TPI
Y1	$72,000
Y2	$78,000
Y3	$70,000
Y4	$75,000
Y5 (current)	**$232,000**

Y5 income breakdown

Baseline session work: $72,000
Sync fee (from Y2 co-write): $160,000

Calculation

Average TPI

```
= (72,000 + 78,000 + 70,000 + 75,000) / 4
= $73,750
```

AASPI

```
= max( 0 , 232,000 - 73,750 )
= $158,250
```

Teaching point

The sync fee was earned for work performed in Y2 but is assessable in Y5 (year of receipt). Averaging restores some of the equity that the cash-basis assessment distorts. Estimated benefit ~$13,000 to $14,000.

Worked Example 3: The International Tour

Imogen: Sydney-based conductor; year-long European engagement

The facts

- Australian tax resident (full year).
- Y4 gross TPI: AUD 420,000.
- Of which AUD 350,000 foreign-sourced (European orchestra engagement).
- Host-country withholding: AUD 75,000.
- Y1 to Y3 average TPI: AUD 165,000.
- AASPI: max(0, 420,000 minus 165,000) = AUD 255,000.

CRITICAL: Order of Operations

1. Compute total taxable income (AU + foreign sources).
2. Identify TPI INCLUDING foreign-sourced TPI gross of foreign tax.
3. Apply Division 405 averaging to compute the offset on AASPI.
4. Compute final tax payable AFTER averaging.
5. Apply FITO to reduce final tax (subject to s 770-75 cap).

Common error: reducing TPI by foreign withholding BEFORE averaging. This is wrong. TPI is gross of foreign tax for AASPI. FITO is a separate, later offset.

Worked Example 4: The Publishing Advance

Kavi: songwriter receives $180,000 advance against future royalties

The deal

- Three-album publishing deal signed in Y3.
- Upfront advance: $180,000 (non-refundable).
- Recoupable against future royalties.
- No requirement to repay if songs do not earn enough.
- Y3 baseline TPI before advance: $45,000.
- Y3 total TPI: $225,000.

Three issues for the workpaper

1 Timing

Assessable in Y3 on receipt. No statutory mechanism to spread the receipt across the album cycle. Averaging is the only smoothing tool.

2 Character

Derives from authorship of musical works. It is TPI. If structured as a repayable loan it would be balance sheet, but most Australian publishing advances are not repayable. Read the contract.

3 Recoupment

Future royalties recouped against the advance are still TPI in the year earned. The advance was already taxed in Y3. The "unrecouped balance" on publisher statements is informational only.

Top 5 Errors in Musician Files

What reviewers catch and why

#	Error	Consequence
1	**Failing to identify the first qualifying year**	Wrong base year; all AASPI calcs wrong; benefit overstated or understated
2	**Including teaching income in TPI**	AASPI overstated; reviewer sign-off withheld
3	**Foreign withholding netted against TPI before averaging**	Wrong order of operations; benefit understated by thousands
4	**Treating publishing advance as deferred income**	Wrong year of derivation; ATO position vulnerable
5	**Missing APRA AMCOS Q4 or PPCA annual distribution**	TPI understated; revisit required after lodgement

Group Discussion

How would you respond to your client?

Scenario

Your musician client emails. "I just got offered a sync deal for $200,000 for a track I wrote three years ago. Should I take it as a lump sum in this financial year, or ask them to split the payment across two years to reduce my tax?"

What do you tell them?

- Has the client been receiving averaging benefit in prior years? Check the AASPI calc history.
- What is their average TPI? Is the $200,000 likely to be AASPI or absorbed into the average?
- Splitting the payment across two years risks the second tranche being assessed in the same year if the contract is signed before 30 June (timing of derivation question).
- Averaging will smooth the spike anyway. A genuine split needs to be structured before the contract is signed, not after.
- Practical advice: take the lump sum, claim averaging, document the calculation.

The Reviewer Mindset

What you accept when you sign off a musician file

When you sign off a musician averaging file, you are accepting professional responsibility for an income classification that the ATO may revisit if the client is later audited. Your sign-off should reflect that the workpaper would withstand independent scrutiny.

Five questions to ask yourself before signing

- Have I confirmed the FIRST qualifying year and rebuilt the prior TPI history?
- Have I traced each income item to TPI versus non-TPI classification with source documentation?
- Have I confirmed teaching, journalism, salary, and capital amounts are EXCLUDED from TPI?
- For foreign income: have I applied averaging BEFORE FITO (not the other way around)?
- Have I obtained APRA AMCOS, PPCA, distributor, label, and publisher statements direct from portals (not just client-emailed copies)?

Key Takeaways

The five things that should stick

1

Division 405 is one-way

Musicians get an offset in high years but never face complementary tax in low years.

2

Identify the first qualifying year

The first year TPI reached $2,500 is the base year. Interview the client about their full career history.

3

TPI vs non-TPI reconciliation is mandatory

Teaching, journalism, capital amounts, and investment income are excluded. Workpaper must show the apportionment.

4

FITO comes AFTER averaging

For foreign-tour musicians, the order of operations matters by tens of thousands of dollars.

5

Publishing advances are TPI on receipt

No spreading across the contract period. Averaging is the only smoothing tool.

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Questions, Discussion, Next Steps

Thank you

Next steps

1. Read the Musician industry companion guide end-to-end before your next musician file.
2. For your next AASPI calc, perform the manual recalculation in parallel with the software output.
3. Bookmark the worked examples (slides 13 to 16) for reference when you next see a similar scenario.

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