



**Macquarie University**

**Graduate Accounting and Commerce Centre**

**Division of Economics and Financial Studies**

**ACCG882**

**ADVANCED TAXATION**

**UNIT PROGRAM 2008**

**FIRST SEMESTER**

Unit Description and Objectives

This unit looks at income tax and fringe benefits tax law and its practical application in Australia today. We also look at the GST provisions. The unit is broken up into seminars, which will be in the form of the discussion of assigned questions on specified topics, which, in the main, will apply the law to fact situations. Discussion will be in a class format as well as small groups and presentation to the class.

Whilst the unit aims at further developing an understanding of revenue law and the ability to undertake critical analysis from the basic knowledge obtained at undergraduate level, it also has as a key objective the ability to apply the law to a problem or fact situation and come up with a logical piece of advice.

Prerequisites

Students must have completed an undergraduate unit in Australian taxation law before commencing this unit.

Texts and Reading Materials

**Students must purchase:**

**2008 Australian Master Tax Guide CCH  
2008 Core Tax Legislation and Study Guide CCH**

**Note:**

**(a) STUDENTS SHOULD ALWAYS BRING COPIES OF THE TAXATION ACT TO EACH WEEKLY SESSION.**

**(b) CURRENT LEGISLATION, TEXT AND CASEBOOK ONLY SHOULD BE USED.**

For a good coverage of the topics in the course no one textbook can be recommended but rather a

number of texts and journal articles. For each seminar topic a number of texts will be referred to and journal articles where relevant.

#### Key Text

Woellner, Barkoczy, Murphy and Evans "Australian Taxation Law" 18th Edition, CCH 2008 (Woellner)

#### Other Texts

Cooper, Krever and Vann "Income Taxation: Commentary and Materials" 6<sup>th</sup> Edition 2005 Thomson

Australian Master GST Guide 8<sup>th</sup> Edition CCH 2007

#### Case Study Texts

Coleman, Hart, McKercher and Ting "Australian Tax Analysis: Cases, Commentary, Commercial Applications and Questions" 2006 6th Edition Thomson

Fisher and Hodgson "Tax Questions and Answers 2007" Thomson

Nethercott, Richardson and Devos "Australian Taxation Study Manual" 16th Edition CCH 2006

CCH Editors "Master Tax Examples" 6th Edition CCH 2007

#### Case Book

Stephen Barkoczy "Australian Tax Casebook" CCH 8th Edition 2007

Krever, Black and Coleman "Australian Income Tax Cases" 2006 Thomson

#### Electronic Resources

The library database offers TaxPoint (Thomson) and CCH Online. These electronic resources include up-to-date discussions concerning income tax legislation, cases, rules and articles and will be very useful for this unit.

#### Journals

Reference should be made to journal articles in keeping up to date with developments in tax law and practice. These include:

- Australian Tax Forum
- Australian Tax Review
- Taxation in Australia
- Tax Specialist
- The Australian Accountant
- Journal of Australian Taxation
- The Chartered Accountant in Australia "Charter"
- The Australian Law Journal contains a section called "Revenue Notes" which features articles on important decisions.

#### Rulings

The Rulings released by the Commissioner and tax cases are available from the Library database or from the internet. The ATO website [www.ato.gov.au](http://www.ato.gov.au) includes a legal database from which you can download rulings and cases.

#### Seminars

The unit is made up of 12 weekly workshop seminars each of three hours duration. There will be a minimum of formal lecturing and it is envisaged that the workshops will cover specified topics and based on problems assigned to the workshop as well as discussion of journal articles and decided cases on the topic. Each student is expected to participate in each workshop and accordingly must read the required readings for each session. Students will also be expected to present an answer to an assigned question and that will be collected and marked.

### Unit Assessment

The following weights will apply

Final examination (open book)	70%
Assignment	<u>30%</u>
Total	100%

### **GENERAL NOTES ON ASSESSMENT PROCEDURES**

- a) The final examination will be held on 3 June 2008 commencing at 6.00 p.m. It will be a 3 hour open book written examination plus 10 minutes reading time.
- b) Assignment due: 6 May 2007  
Estimated word length 3000 words.
- c) Students are expected to participate in discussion each week.
- d) Assignments to be submitted to the lecturer must be legibly written in ink not pencil, preferably typed. Untidy, illegible or inadequate work may not be marked.
- e) Plagiarism will result in a zero mark
- f) **All answers must be substantiated with references to the relevant provisions of the Income Tax Assessment Act 1936 and 1997(as amended), decided cases and interpretive rulings issued by the Australian Taxation Office where appropriate.**
- g) **STUDENTS ARE STRONGLY ADVISED TO KEEP COPIES OF EACH WRITTEN ANSWER SUBMITTED TO THE LECTURER.**

### Staff

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### Student Consultation

Consultation time: Monday 11.30 -1.30pm

Student consultation in relation to any question about the course content or related issues can be facilitated by emailing the lecturer, then if need be, by arranging a visit in consultation hours (Monday 11.30am to 1.30pm) or at another time arranged with the lecturer.

### Generic Skills

Advanced Taxation seeks to develop both generic skills and specific knowledge. A student passing this course must demonstrate an ability to apply their knowledge of the taxation laws in Australia to a given problem question and in doing so give authority for their advice from relevant tax legislation and case law. The written assignment requires the student to apply their knowledge obtained during the course

and to develop a critical thought process in supporting their conclusions on application of the taxation laws in Australia

Students also become familiar with current developments in taxation law in the requirement to be aware of tax office rulings and recent case law that are referred to in the unit outline.

The skills required for independent and reflective learning will be developed through the completion of the written assignment as it requires each student to analyse a given fact situation without any direction as to the taxation issue, just as if a client had requested the advice. This ability is further extended in seminar discussions.

Students will further develop their communication skills necessary for a successful commerce related career through the presentation and participation in class. This requires the student to work, at times, as part of a group in analysing questions.

### Time and Location of Seminar

Tuesday 6-9pm  
E4B316

### Plagiarism

The University defines plagiarism in its rules: "Plagiarism involves using the work of another person and presenting it as one's own." Plagiarism is a serious breach of the University's rules and carries significant penalties. You must read the University's practices and procedures on plagiarism. These can be found in the *Handbook of Undergraduate Studies* or on the web at:

<http://www.student.mq.edu.au/plagiarism/>

The policies and procedures explain what plagiarism is, how to avoid it, the procedures that will be taken in cases of suspected plagiarism, and the penalties if you are found guilty. Penalties may include a deduction of marks, failure in the unit, and/or referral to the University Discipline Committee.

### University Policy on Grading

Academic Senate has a set of guidelines on the distribution of grades across the range from fail to high distinction. Your final result will include one of these grades plus a standardised numerical grade (SNG).

On occasion your raw mark for a unit (i.e., the total of your marks for each assessment item) may not be the same as the SNG that you receive. Under the Senate guidelines, results may be scaled to ensure that there is a degree of comparability across the university, so that units with the same past performances of their students should achieve similar results.

It is important that you realise that the policy does not require that a minimum number of students are to be failed in any unit. In fact it does something like the opposite, in requiring examiners to explain their actions if more than 20% of students fail in a unit.

The process of scaling does not change the order of marks among students. A student who receives a higher raw mark than another will also receive a higher final scaled mark.

For an explanation of the policy see

<http://www.mq.edu.au/senate/MQUonly/Issues/Guidelines2003.doc> or

<http://www.mq.edu.au/senate/MQUonly/Issues/detailedguidelines.doc>

### Student Support Services

Macquarie University provides a range of Academic Student Support Services. Details of these services can be accessed at <http://www.student.mq.edu.au>

### Classroom Etiquette

Students are expected to arrive on time, certainly before five minutes past the hour, and not to leave until the class ends. If you have a recurring problem that makes you late, or forces you to leave early,

have the courtesy to discuss this with your lecturer/tutor. Students are expected to be quiet during lectures unless, of course, class participation is required. Mobiles should be turned off during classes; not simply set to "silent".

Summary of Unit Program

<b>Week</b>	<b>Date</b>	<b>Seminar Topic</b>
1	26/2	Introduction
2	4/3	Capital/Income distinction, Carrying on business, Income from isolated transactions
3	11/3	Income from personal exertion Fringe Benefits Tax
4	18/3	Taxation of capital gains
5	25/3	Goods and Services Tax
6	1/4	Eligible Termination Payments, Superannuation, Derivation and trading stock
<b>8/4 no class</b>		
7	15/4	Deductions
8	22/4	Taxation of Trusts and Beneficiaries
9	29/4	Partnerships and taxation of partners
10	6/5	Taxation of companies and shareholders
11	13/5	International Taxation
12	20/5	Tax Administration, Enforcement and Anti-avoidance.
EXAM	3/6	

## **WEEK TWO**

### **Capital/Income Distinction, Income from business and isolated transactions.**

#### **Background Reading:**

MTG Paragraphs    10000 -10040  
                          10110 -10116  
                          10340 -10350  
                          10430 -10450

This week we look at an issue pivotal to an understanding of income tax law in Australia, that is the meaning of income in Section 6-5(ITAA1997) as distinct from receipts of a capital nature. Illustrative of the distinction are cases dealing with income from isolated transactions.

We look at what constitutes the carrying on of a business and after coming to some understanding consider the law relating to income from isolated transactions.  
See Section 6-5(1), (2), (3); 6-10(1), (2), (4), (5); 6-15 of ITAA (1997).

#### **Relevant Cases :**

##### **Carrying on business**

Bradjkovich v FC of T 88 ATC 457  
Ferguson v FC of T 72 ATC 4261  
FC of T v JR Walker 85 ATC 4179  
Babka v FC of T 89 ATC 4963  
Hart v Federal Commissioner of Taxation (2002) FCA 1559  
Federal Commissioner of Taxation v Stone 2005 HCA 21  
Vance v Federal Commissioner of Taxation 2005 4808  
Ell& Anor v Federal Commissioner of Taxation 2006ATC FCA 71

##### **Income from isolated transactions**

CMI Services P/L v FC of T 90 ATC 4428  
FC of T v Merv Brown Pty Ltd 85 ATC 4080  
GP International Pipecoaters P/L v FC of T 88 ATC 4823  
Kosciusko Thredbo P/L v FC of T 84 ATC 4043  
Memorex Pty Ltd v FC of T 87 ATC 5034  
Cyclone Scaffolding Pty Ltd v FC of T 87 ATC 5083  
FC of T v GKN Kwikform Services P/L 91 ATC 4336  
Scottish Australian Mining Co. Ltd v. FCT (1950) 81 CLR 188  
London Australia Investment Co. Ltd v FCT (1977) 138 CLR 106  
Whitfords Beach Pty Ltd v FCT 83 ATC 4277  
AGC Investments Ltd v FCT 92 ATC 4239  
Hyteco Hiring Pty Ltd v FCT 92 ATC 4694  
Westfield Ltd v FCT 87 ATC 4234  
FCT v Myer Emporium 87 ATC 4363  
Moana Sand Pty Ltd v FCT 88 ATC 4897  
FCT v Cooling 90 ATC 4472  
Henry Jones (IXL) Ltd v FCT 91 ATC 4663  
FC of T v Spedley Securities Ltd 88 ATC 4126  
FC of T v Rowe 97 ATC 4317  
Lees and Leech Pty Ltd v FC of T 97 ATC 4407  
FC of T v MIM Holdings 16/5/97  
Montgomery v FC of T 98 ATC 4120  
O'Connell v FC of T 2002 FCA 904

**Rulings:**

Taxation Ruling TR 92/3: Profits from isolated transactions

Taxation Ruling IT 2631: Income Tax: Lease Incentives

Taxation Ruling TR 97/11: Business of Primary Production

Taxation Ruling 2005/1: Carrying on Business as a Professional Artist

**Discussion Questions**

**Question One**

Joe likes to gamble. He has a full-time job that requires no weekend work and little overtime. His only interest outside work, apart from his close family relationships, is horse and harness racing. His wife shares this interest and accompanies him to the racetrack each week.

He set aside a separate room in his home (which is mortgaged) as his gambling office. This contains a desk, a computer and a filing cabinet. He leases a telephone commander system to allow several telephone calls to be conducted at the same time and, in addition to buying morning and evening newspapers to study the racing pages, he subscribes to Punters' Guide Weekly that provides details about horse racing and trotting. Three times a week he makes a 10kilometre round trip to observe early morning training sessions at the racetrack and to talk to trainers and jockeys, many of whom he regards as friends.

Joe keeps records for individual horses detailing their races, the prevailing conditions, the odds and results. It is from this information together with guide notes and his own assessment of a horse's prospects, based on his observations and discussions with others in the industry that he decides upon his bets. Joe maintains a daily financial record of the total outlays and returns, betting principally with the TAB maintaining a minimum \$2,000 credit balance.

**Outline the factors that would be considered in deciding whether a person is in the business of gambling and by reference to case reports, discuss whether Joe's gambling activities would amount to carrying on a business of gambling.**

**Question Two**

X Ltd, a wholly owned subsidiary of Telbeck Ltd, a resident of Australia, was incorporated in Australia, for the sole purpose of carrying out a contract let by Telstra Corporation Ltd [Telstra]. That contract involves the manufacture and installation of a laser-micro link from Darwin to Brisbane to be used for multi-media transmission and reception. The contract is for 18 months, commencing on 1 August 2006 and requires X Ltd to install the link system over land (licences are in place). The contract provides:

- \* Telstra to pay X Ltd \$5,000,000 upon commencement of the contract, such sum to be used to establish the factory to produce the special links required for the system; and
- \* Telstra to pay X Ltd one-fifteenth of the balance of the contract sum at the end of each month, the first such payment due at the end of the fourth month after commencement of the contract.

Assuming that the contract went ahead as planned, advise X Ltd of the likely tax treatment of receipts under this contract.

**Question Three**

Boodles Pty Ltd is a family company whose shareholding is in the joint names of Mr and Mrs Boodles. In 1958 Boodles Pty Ltd purchased a 100hectare property at Gosford for 50,000 English pounds. Until 1993 the property was worked as a citrus orchard. In September 1992 Mr Boodles suffered a coronary occlusion and was told by his medical advisers that he should not do any further manual work.

In January 1994, Mr and Mrs Boodles decided to subdivide and sell the property. Surveyors were employed to map out the lots and after successfully obtaining council approval to subdivide the site, they decided to abandon the project and sold their shares to Goldacre Ltd for \$12m in October 2004. Under the direction of the new Board, Boodles Pty Ltd completed the development of the property by employing engineers to mark out roads and drainage, installing telephone and electricity services and by building several speculative homes. The original estimates projected a profit of \$6.5m with an expectation that all the lots will be sold from June 2007 to December 2007.

The site and building works were completed by March 2007 and by December 2007 only one half of all the lots had been sold. Some of the sales had been vendor-financed with 20% deposit paid and 80% payable over 10 years at 12% interest.

**Advise Boodles Pty Ltd on the tax consequences of this project.**

#### **Question Four**

Tools Pty Ltd leased to tradesman tooling equipment. Should a tradesman want to buy the equipment or if it was not returned by the due date Tools Pty Ltd would sell the equipment to them at the retail list price. The contract for leases did not address rights and obligations should the equipment not be returned.

Tools Pty Ltd advertised as “offering tooling equipment for lease” and the amount of sales of equipment was always less than 10 per cent of gross receipts each year.

**Advise Tools Pty Ltd whether they should include receipts from sales of tooling equipment in assessable income.**

#### **Question Five**

Popup Ltd sells imported clothing by wholesale and holds ten valuable import quotas that allow it to import stock. Popup wishes to restructure its business and for that purpose, sells two of its quotas at a profit.

Popup has a license to reproduce pictures of Disney characters on t-shirts and other types of clothing for a 10year period. Popup charges a fee (royalty) per reprint made by clients. To obtain additional funding Popup enters into an arrangement under which it assigns its rights to receive royalties with respect to the reprints to a finance company, Finances Ltd, for 10 years in return for a lump sum payment of \$10 million.

Popup and Finances are not related. Finance’s agreement to take the assignment of unpaid royalties is on purely commercial grounds.

**Advise the parties of any income tax implications.**

#### **Question Six**

James is currently employed by the Rebel Sport Retail Chain but also competes in Australia and Internationally in marathon running competitions. James is aiming to make it into the Australian squad for the Beijing Olympics. Rebel Sport pays James an allowance of \$500 a month on the condition that James wears a cap with the Rebel logo when he trains and competes and Nike provides James with running shoes as and when he needs them. James and Rebel Sport have agreed that if James needs leave to participate in competitions he will be entitled to leave without pay.

During the year ended 30 June 2008 James won \$100,000 as a result of his participation in various Australian and International marathons and he seeks your advice as to the assessability of the prize money and any other income tax issues that he should be aware of.

### **Question Seven**

What do you think were the reasons for the different decisions in FCT v Cooling, Lees and Leech Pty Ltd v FC T and Montgomery v FCT ?

Does O'Connell v FC and T now make it clear how lease incentives will be treated?

## **WEEK THREE**

### **Income from Personal Exertion Fringe Benefits Tax**

The objective of this seminar is to briefly cover the basic principles of income from personal exertion as well as the interrelationship between the Income Tax Assessment Act ("ITAA") and the Fringe Benefits Tax Assessment Act. ("FBTAA")

In addition we will look at the taxation of employee share acquisition schemes.

### **INCOME FROM PERSONAL EXERTION**

#### **Background Reading:**

MTG Paragraphs 10-050 - 10-076

#### **a) Gratuitous Payments and Windfall Gains:**

##### **Relevant Cases:**

FC of T v Dixon (1952) 86 CLR 540  
Hayes v FC of T (1956) 96 CLR 47  
Scott v FC of T (1966) 117 CLR 514  
FC of T v Harris (1980) 10 ATR 869  
Smith v FC of T (1988) 164 CLR 513  
Kelly v FC of T 85 ATC 4283

You should already be quite familiar with these cases from your undergraduate study.

##### **Some more recent cases**

Payne v FC of T 96 ATC 4407  
Paykel v FC of T 94 ATC 4176  
Reuter v FC of T 93 ATC 4037, 5030  
Roads & Traffic Authority of NSW v FC of T 93 ATC 4508  
Dean v FCT 1995 ATC/Case 25/97  
FCT v Holmes 1995 ATC  
FCT v Rowe 97 ATC 4317  
Case 1/97  
Mclean and Anor v FC of T 96 ATC 4443  
Brown v FC of T 02 ATC 4273

##### **Rulings:**

Taxation Ruling TR 92/15 "Income Tax & FBT The Difference Between an Allowance and Reimbursement"

Taxation Ruling TR 95/3 "CGT: Restrictive Covenants and Trade Ties"

Taxation Determination TD 93/229 "Reimbursement/Salary & Wages"

Taxation Ruling TR2001/01 Salary Sacrifice Arrangements

## **b) Payments for Service Contracts**

### **Cases:**

Brent v FC of T 71 ATC 4195

Hepples v FC of T 91 ATC 4808

Paykel v FC of T 94 ATC 4176

Dean v FCT 32 ATR 647

Case 1/2000 2000 ATC 101

### **Rulings:**

Income Tax Ruling TR 95/3 (see above)

## **c) Employee Share Acquisition Schemes ("ESAS")**

### **Background Reading:**

MTG 10-080-10-092

### **Relevant Sections:**

Div 13A

## **d) Fringe Benefits Tax**

### **Background Reading:**

Master Tax Guide Chapter 35

### **Cases**

J & G Knowles & Associates Pty Ltd v Federal Commissioner of Taxation 2000 ATC 4151

J & G Knowles & Associates Pty Ltd v Federal Commissioner of Taxation 2000 AATA 846

Starrim Pty Ltd v Federal Commissioner of Taxation 2000 FCA 952

### **Rulings:**

TR 97/17 Meal Entertainment

## **e) Personal Service Business**

### **Background Reading:**

MTG 30-600-30690

### **Case**

Federal Commissioner of Taxation v Dixon Consulting Pty Ltd 2006 FCA 1748

## Discussion questions

### Question One

Fiona Parsons who lives in Melbourne is a management consultant with Staedler Ltd, an American company specialising in the development of information systems for the publishing industry. In March 2007, Staedler won a tender contract to install a new computer system for EZI Ltd located in Singapore. As a result, on 1 April 2007, Parsons was posted to Singapore for one month to arrange installation of the system. Due to technical difficulties in the installation, Parsons stay was extended by a further three months. Initially her salary of \$8,000 per month was paid into a bank account in Melbourne. However, from May her salary was paid into a Singapore bank account. Upon completion of her work, EZI presented Parsons with two airline tickets and vouchers for a holiday in London valued at \$8,000. EZI also offered Parsons a three-year consulting job with the company with an annual salary of \$100,000 and a car. As an incentive to join EZI and to compensate for her leaving Staedler and having to move permanently to Singapore, she was offered \$40,000. This was paid - \$20,000 on joining the firm and \$20,000 after one year's service. Parsons accepted the offer on 1 September 2008.

**Advise Parsons as to the assessability of the above amounts in Australia for the years 2007 and 2008.**

### Question Two

Abbey Jones was employed by Block Publishing as the marketing manager commencing 1 July 2007. His employment contract included the following forms of remuneration;

1. \$80,000 P.A.
2. Superannuation contributions to Block Publishing Superannuation Fund \$10,000 P.A.
3. Entertainment allowance \$3,000 P.A.
4. Telephone rental and charges up to maximum of \$1,500 P.A.
5. Motor vehicle provided
  - Cost to Block Publishing \$60,000
  - Total travel for the year 8,000 km
  - 50% private usage
  - No log-book was maintained
6. Car parking fees paid.
  - \$6.00 a day in Kings Parking Station
7. Interest free loan of \$100,000 to Abbey on 1 July 2007.
  - Abbey plans to put the money towards the purchase of a principle residence.
8. Lap-top computer provided for use at home.
  - Cost \$4000
9. On 1 July 2007 Block Publishing will issue 500 shares in Block Publishing to Abbey for nil consideration. Note that all employees are eligible to participate in the scheme.
  - Market Value 1 July 2007 \$1.50
10. Abbey previously worked for a competitor of Block Publishing in Melbourne. Block Publishing agreed to compensate Abbey for the costs of temporary accommodation on his arrival in Sydney before he obtained his principle residence-\$5000. Block Publishing also paid the cost of airfares for Abbey to fly from Melbourne to Sydney-\$600.
11. Abbey signed a confidentiality agreement for \$5000 paid on the date the employment contract

was signed. Abbey also received a further \$5000 for agreeing to work for Block Publishing for a minimum of 5 years.

12. Abbey had been a director of the Marketing Directors Association, a professional association. Block Publishing agrees to compensate Abbey \$3000 for agreeing to resign his directorship in respect of which he had received \$1500 P.A. for representations in that capacity.

13. Abbey attended a conference in Los Angeles between 20-27 June 2008. The conference is titled " Marketing Strategies in the 90's" and covered a 6 day period. The last 2 days Abbey spent sightseeing. Block Publishing paid for all the costs associated with the trip. Abbey kept a complete travel diary and all records as requested by Block Publishing.

Airfares	\$4000	Accommodation	\$2000
Conference Fees	\$2000	Food and Drink	\$1000

14. Abbey was nominated by Block publishing for the Marketing Manager of the Year Award and Abbey won a set of luggage as winner of the award as well as a trophy which sits on his office desk.

### **Additional**

Whilst working for Block Publishing Abbey was required to travel extensively and having accumulated sufficient Frequent Flyer points cashed them in to cover the airfare to Daydream Island on 1 June 2008 worth \$800.

Abbey had become a member of the Frequent Flyer Club in his own name and all points were accumulated whilst travelling for work.

### **Required**

**What are the tax implications to Block Publishing and Abbey in respect of the above stated items?**

### **Question Three (additional)**

Head Office Canberra Ltd (HOC) has branches in all states of Australia. After five years satisfactory performance at branch level, certain managers are seconded to Canberra for a two-year period to learn about the company from a head office perspective. Most employees return to their state office after two years but managers who show outstanding potential are usually asked to consider permanent relocation to Canberra during their two-year secondment.

All secondees are provided with the following cash and benefits package on accepting a two-year secondment to Canberra.

- \* \$60000 salary
- \* \$5000 travel allowance
- \* \$400 per week rental allowance plus payment of rental bond
- \* relocation of household furniture and relocation of up to two motor vehicles to Canberra
- \* payment of insurance to cover removalist's negligence
- \* storage of other household furniture not relocated to Canberra
- \* rental of household furniture in Canberra
- \* \$50 a week allowance for additional food costs above local state food costs
- \* Childcare facilities on work premises for his two children
- \* Airfares provided for family members to get to Canberra and back again, plus two visits per annum to the home state.

After two months in Canberra, Henry from Hobart is asked by HOC if he would like to remain in Canberra on a permanent basis.

In addition to the above benefits, the company offers Henry the following benefits:

- \$20000 pay rise
- all costs associated with selling Henry's Hobart residence and acquiring a house in Canberra including legal fees, bank loans, real estate agents commission on selling the former residence and stamp duty on acquisition of the new residence.

Henry accepts the offer one month later, and plans to purchase a new house in Canberra after the sale of his former residence in Hobart.

### **Required**

**Advise HOC of the tax implications to itself and its employees in providing the benefits listed to employees who are seconded to Canberra on a temporary two-year basis.**

**How would your answer change in respect of Henry's situation? Consider also the tax implications of the additional benefits provided to Henry from both the employer's viewpoint and Henry's.**

## **WEEK FOUR**

### **Taxation of Capital Gains**

#### **Background Reading:**

MTG Chapter 12 and 13

**This week we look at:**

- (i) The definition of an asset for the purposes of Part 3-1 and 3-3 ITAA 1997**
- (i) Concept of Acquisition and Disposal**
- (iii) Cost base, reduced cost base and consideration**
- (iv) Calculation of Gains & Losses**
- (v) Exemptions**
- (vi) Roll-over Relief**

The application of capital gains tax to trusts and partnerships will be dealt with in Weeks 8 and 9 respectively.

#### **Cases:**

Hepples v FC of T 91 ATC 4808, 92 ATC 4013  
Reuter v FCT 93 ATC 4037

Paykel v FCT 94 ATC 4176  
Dingwall v FCT (1995) ATC 4345  
Callow v FC of T 97 ATC 4350  
FCT v Krakos Investments 96 ATC 4063  
Granby Pty Ltd v FC of T 95 ATC 4240  
FCT v Murry 96 ATC 4703 / FCT v Murry ( 1998 ) HCA 42 16 June 1998  
Case 11/96 ATC 199  
Gardiner v FC of T 2000 ATC 2018  
Federal Commissioner of Taxation v Sara Lee Household and Body Care (Aust) Pty Ltd 2000 ATC 4378  
McDonald and Anor v Federal Commissioner of Taxation 2001 ATC 4146(Leave to appeal to High Court denied)  
Lend lease Custodian Pty Ltd v deputy Commissioner of Taxation 2007 ATC 4041

### **Rulings:**

TR 95/35 "CGT & Compensatory Payments"  
 TR 95/3 "CGT: Restrictive Covenants & Trade Ties"  
 PCD No 8 "Capital Gains: Goodwill"  
 TR 96/24 "Capital Gains"

### **Discussion Questions**

#### **Question One**

Marc purchased an acre of land by the lake on 1 October 1990 for \$300,000.

Other costs incurred by Marc in respect of the purchase of the land were as follows:

Stamp Duty \$8,000  
 Legal costs on conveyance \$3,000  
 Water rates- Included in the contract \$90  
 Council fees- Included in the contract \$350

Marc took some time off his full time employment and personally built a home on the land for rental purposes. He incurred the following costs:

1 April 1997	
Establishment fee for interest only loan, taken out to build the house	\$2,500
2 April 1997	
Development application fee payable to Council	\$5,500
20 April 1997	
Legal fees and Land and Environment Court costs arising out of the appeal against Council's refusal of the Development Application	\$32,000
1 May 1997	
Deposit to Council for road works (refunded after house built)	\$2,000
5 May 1997	
Building materials	\$130,000
20 June 1997	
Architectural fees	\$11,000
3 April 1997-	

30 June 1997

Labour (based on Marc's personal time to build the house at \$20.00 per hour over three months)

\$16,800

Marc received a market rental for the property from 1 July 1997 until its sale.

Marc obtained an interest only loan to fund the building of the house on 1 April 1997. The loan was repaid on 31 March 1999. The total interest Marc paid from 1 April 1997 to 31 March 1999 was \$60,000.

Luca a cousin of Marc offered to purchase the land and house. Marc retained the services of a qualified valuer to value the property for \$4,000, paid on 15 May 2008. The market value of the land was \$400,000 and the house was \$300,000.

Marc entered into a contract to sell the land for \$330,000 and the house for \$240,000 to Luca on 20 June 2008. The sale was settled on 1 August 2008. Luca also gave Marc a car valued at \$50,000 in respect of the sale of the house.

Marc also sold the following parcels of shares during the year ended 30 June 2008:

#### **Investment portfolio transactions for the year**

- 2000 BHP shares (1500 acquired on 1 May 1984 at \$12,000 & 500 acquired from a 1:3 bonus issue out of a share premium reserve on 1 Sept 1989 (m. value at that date \$10). Sold 1 July 2007 for \$25,500.
- 2000 Elders IXL shares acquired on 5 August 1988 at a cost of \$4,000. He was forced to sell this parcel of shares on 30 November 2007 at \$3,000 to prevent further loss. Brokerage costs of \$280 were incurred in the acquisition and of this parcel of shares as well as \$220 on their sale.
- 500 CRA shares (received from his father's estate) sold on 29 September 2007 for \$4,000. (Her father purchased these shares on 2 June 1978 for \$1.10 each and they had a market value of \$4 per share at the time of her father's death on 2 August 1990). Brokerage fees of \$100 were incurred on the sale of these shares.

#### **Speculative portfolio transactions ( shares were purchase for the purpose of resale) for the year**

- 3000 MIM shares (purchased 2 August 1991 for \$3 each), sold on 4 November 2007 for \$5 each. Brokerage was \$100 on purchase and \$200 on sale.

**Assuming Marc derived no other income, calculate Marc's taxable income and tax payable for 30 June 2008.**

**Also advise Marc on the tax implications of the sale of the house and land if he only rented out a room in the house that is about one tenth of the area and lived in the rest of the house during the entire period of ownership.**

#### **Question Two**

In 1983, Sally was driving down to Culburra to spend the weekend with friends. On the way down to Culburra, she spotted some beachfront land for sale just south of Jervis Bay. She discussed this land with her friends and decided that as she had just retired, she could buy this land and build her retirement home on it.

She bought the land in February 1984 and immediately put her plans into council. They were approved in April 1984. Building on her retirement home commenced in July 1984.

In October 1984, her grandchildren were orphaned by a car accident. As a result of this, Sally's retirement plans changed because she now had to stay in Sydney to bring up her grandchildren. She immediately stopped the work on her retirement home and the half finished home fell into disrepair.

After a year and a half, Sally's life began to regain some form of normality and she decided that although she would not be retiring to Jervis Bay, she would turn the semi-finished retirement home into a holiday house for her grandchildren who were active swimmers and tennis players. In May 1986, she put revised plans into council to finish off the building she had begun in September 1986.

However, as the building had deteriorated, the renovation needed to complete the work cost Sally \$79,000. She also installed a pool at a cost of \$4,000.

To allow her grandchildren to develop their tennis skills she wanted to build a tennis court, so in December 1987 she bought an adjacent block of land for \$30,000 and built a tennis court thereon at a cost of \$5,000.

Over the next 19 years Sally and her two grandchildren, Bill and Ben, spent many joyous times down at their holiday house. Suddenly, in January 2007, Sally collapsed and died.

The holiday house was bequeathed in equal shares to Bill and Ben. However, being at the holiday house without their grandmother was too distressing for the boys, so in May 2008 they sold the holiday house with the adjoining tennis court for \$400,000.

**Discuss the tax consequences of this sale for Bill and Ben.**

**What relief would be available to Bill and Ben if instead of selling the holiday house they turned it into a hotel and transferred it to a company?**

### **Question Three**

In July 1985 Effie Pty Ltd acquired a block of home units for \$400,000. The block was sold by Effie Pty Ltd in December 2007 for \$600,000.

At the time of acquisition of the home units the shareholding in Effie Pty Ltd was as follows:

Effie Family Discretionary Trust	75%
Mrs Effie	25%

(The beneficiaries of the Trust are Mr and Mrs Effie, their children, their children's spouses and future issue).

In September 1991 the shareholding was rearranged as follows:

Effie Family Discretionary Trust	25%
Mrs Effie	20%
Kay Pty Ltd (an unrelated party)	55%

A further reorganisation occurred in March 1992 (which currently exists) with the following outcome.

Effie Family Discretionary Trust	25%
Mrs Effie	20%
Kay Pty Ltd	40%
Mr Effie	15%

**Discuss whether a capital gain arises on the sale of the block of units.**

**What difference would it make if Effie Pty Ltd was a public company, unit trust or a partnership?**

#### **Question Four**

**Consider the following unrelated transactions during the year ended 30 June 2008.**

(i) In August 1986 A (a resident) acquired a canteen of Victorian cutlery 1891 for \$3,000. In May 2008 his residence is burgled and the item is stolen. It is insured for \$4,500.

(ii) B inherited an apartment in New York in September 1999. Its market value at the time was \$A1m. She lives in the residence until February 2005 (market value \$A1m) at which time she is transferred to her employer's Australian office. In January 2008 she resigns and leaves Australia to reside permanently in the Bahamas (Market value of New York apartment \$A1.25m). During her stay in Australia B acquired several parcels of shares in Australian companies and a residential unit in Adelaide.

**Advise the prospective taxpayers in (i) and (ii) above of the capital gains tax consequences of the transactions.**

#### **Question Five**

Max and Molly were in partnership providing gardening and landscaping services in the North Shore. Whilst working on a large commercial project a truck collided with their van and caught fire. The van and all its contents were neither useable nor repairable and had to be replaced.

Max Molly's original claim was for \$60,000 covering:

	\$
Replacing the van	45,000
Gardening Tools	2,000
Jackhammer	3,000
Loss of profits	<u>10,000</u>
	60,000

The trucking company, after a long protracted court case, agreed to pay \$45000 in compensation to the Max and Molly Partnership without reference to any particular item.

#### **Required**

**Advise Max, Molly and the partnership as to the tax consequences of the settlement. Please cite relevant authorities.**

#### **Question Six**

On 5 March 2008, Jan Chan entered into a covenant with her employer, Compu-Tech (NSW) Ltd pursuant to which she agreed not to work for a competitor of Compu-Tech (NSW) Ltd in New South Wales for a period of three years. Jan Chan received \$50,000 for entering into the agreement and incurs \$500 in legal fees in connection with the agreement.

**What are the capital gains tax implications of this receipt?**

**What would be your advice to Jan Chan, if on 5 March 2008 she sold her business (set up on 1 June 1990) as a computer consultant to Compu-Tech (NSW) Ltd comprising the name "Jan Chan Consulting" and client list for \$50,000, simultaneously entering into a covenant not to compete for a period of three years?**

### **Question Seven**

John and Jane own 50% each of the units in JJ Unit Trust. John acquired his interest before 1985, and Jane after 1985. The JJ Unit Trust owns one asset acquired in 1981 with a market value as at 1 July 2007 of \$100,000 and one asset acquired in 1991 with a cost base of \$250,000 and a market value as at 1 July 2007 of \$800,000.

On 1 July 2007 the trustee of the JJ Trust transfers the trust assets to Shelf Co Pty Ltd. John and Jane are issued with 50% each respectively of the shares in Shelf Co Pty Ltd. The JJ Trust is wound up.

**What are the capital gains tax implications of the transfer of the assets to the trust assuming that John and Jane would like to minimise their tax liability in any year?**

### **WEEK FIVE**

#### **GOODS AND SERVICES TAX "GST"**

##### **Background Reading:**

Master Tax Guide Chapter 34

##### **QUESTION ONE**

Paul Griggs runs and owns a clothing factory in Sydney as a sole proprietor. Paul commenced business in October 1990 and turnover has averaged around \$800,000 for the last three years.

Paul has registered for the GST and has an ABN number and asks you the following questions concerning the GST. In answering Paul's questions please explain your advice giving authorities where relevant;

\*Paul placed an order on 1 July 2007 for material from Milan, Italy. The fabric will cost \$20,000 to buy overseas, freight and insurance will be \$5,000 and customs duty \$2,000. What GST would Paul expect to pay on the transaction? When would the GST be due?

\*Based on the information you have been provided about Paul's business what basis should Paul use to attribute GST to each tax period?

\*Paul supplies clothes to his family for free. Clothes Paul provides to his brother John are sold to customers, GST inclusive, at John's retail outlet in Sydney. What are the GST implications of the supply of clothing to a family member for no charge?

\*Paul entered into a contract to sell his business on 1 December 2007. The assets transferred on sale of the business by Paul on 1 December 2007 include the following items:

Goodwill \$200,000  
Trading Stock \$ 20,000  
Depreciable Assets \$50,000  
Factory \$100,000

What are the GST implications on the sale of Paul's business?

##### **QUESTION TWO**

Peter is employed as a computer programmer with Austfox Pty Ltd earning \$120,000 per annum. Peter has a two-year contract with Austfox and works a total of 40 hours a week as and when he pleases. Is Peter required to charge GST on the supply?

## **WEEK SIX**

### **ELIGIBLE TERMINATION PAYMENTS** **TAXATION OF SUPERANNUATION FUNDS**

#### **Background Reading:**

Master Tax Guide Chapters 8 and 11

#### **Question One**

John Todd was made redundant on 30 June 2007 at 63 years of age after 30 years of service with the ABC. John received the following payments:

Redundancy \$60,000  
Accrued Long Service Leave (all post 18/8/93) \$3,000  
Accrued Annual Leave \$3,000  
Superannuation:  
    Pre 1/7/83 \$28,000  
    Post 30/6/83 \$450,000  
Undeducted contributions \$10,000

**Advise John Todd how each of these components would be taxed.**

#### **Question Two**

Z Industries Pty Limited, an Australian resident private company, has its own superannuation fund. The Z Co Employees Superannuation Fund ("the Superannuation Fund") had the following revenue and expenditure for the year ended 30 June 2008:

	\$
<b><u>Revenue</u></b>	
Income from a pooled superannuation trust	54,000
Contributions by the Z Group of Companies on behalf of their employees, based on 8% of their normal salary	55,000
Compulsory contributions from members (Salary Sacrifice)	8,000
Voluntary contributions from members	5,000
Amount received as a result of a new member electing to roll-over from his former employer's superannuation fund, comprising:	
(a) taxed element of post-June 83 component	15,000
(b) undeducted contributions	5,000
Interest	
- from Australian sources	2,000

-	from New Zealand sources (net)	900
Dividend income		
-	public listed companies (franked 80%)	5,000
-	Z Industries Pty Ltd (franked 100%)	10,000
Proceeds from sale of shares -		
	November 2007	14,000

### **Expenditure (excluding investments)**

Retirement benefits	49,000
Trustee's administration fee	1,000
Investment advisers fee	2,000
2002 tax assessment	6,000
Accounting and audit fees	2,000
Insurance premium - death and disability cover	12,000

In addition, the auditors wish to accrue \$300 for the ISC's annual return lodgement fee in relation to the year.

The shares sold were part of the funds portfolio and were acquired in July 1983 for \$12,000. Their market value as at 30 June 1988 was \$10,000.

It is expected that the superannuation fund will be a complying superannuation fund.

### **Required:**

- a) **Set out a statement of taxable income for the year ended 30 June 2008, making references to the relevant statutory provisions and any assumptions deemed necessary. Calculate tax payable.**
- b) **Discuss the options, if any, which the trustee may have to eliminate any tax liability.**

## **DERIVATION AND TRADING STOCK**

In this part of the seminar we consider tax accounting issues such as the meaning of derived and the applicability of a cash or accruals basis of recognising income. We also look at provisions of the Act which deal with trading stock.

### **1. Derivation**

MTG  
Paragraphs 9000 - 9120

Sections: Section 4-1; 4-10, Section 6-5 (4); 6-10 (3)

Choice of Method - Cash or Accruals

- a) distinction between trading and other income
  - Rowe & Sons 71 ATC 4157
  - Australian Gas Light Co 83 ATC 4800
  - TR 96/20 Assessability and deductibility of prompt payment discounts
  - TR 97 /5 Real Estates Commission Income
  - TR 97/15 Income Tax: Conditional Contracts, derivation of income etc
  
- b) Dividends
  - Section 44(1) ITAA 1936
  
- c) Amounts received in advance of the supply of goods or services.
  - Arthur Murray (1965) 114 CLR 314
  - BHP Billiton Petroleum (Bass Strait) Pty Ltd & Anor v F C of T 2002 ATC 5169
  
- d) Income earned by professionals
  - Henderson v FC of T 70 ATC 4016
  - Cardens Case (1938) 63 CLR 103
  - FC of T v Firstenberg 76 ATC 4141
  - Barratt v FC of T 92 ATC 4275
  - Dormer v FCT (2002) 51 ATR 353
  
  - TR 98/1 Determination of income; receipts v's earnings
  
- e) Changing Accounting Method
  - Country Magazine v FC of T (1968) 117 CLR 162
  - Henderson v FC of T 70 ATC 4016
  
- f) Recognition of income from long-term construction contracts
  - Rulings:
  
  - Taxation Ruling TR 93/11
  - Income Tax Ruling IT 2450

## **2.Trading Stock**

MTG 9150-9300

### Principal Sections:

Division 70 1997 Act

s70-10 Definition of "trading stock"

s70-25 Expenditure incurred in the purchase of trading stock is deemed not to be an outgoing of capital or of a capital nature.

s70-15 This section defers the deduction for the cost of purchased trading stock until it comes to be "on hand".

s70-35 Requires that the value of trading stock on hand at the end of a year be taken into account in calculating taxable income.

s70-35(2) Includes the excess of the closing value of stock on hand over the opening value of any stock in assessable income.

s70-35(3) Allows the excess of the opening value of stock over the closing value of stock as a deduction.

s70-40 Requires that the closing value of stock at the end of one year be the opening value of the next year for the stock.

s70-45,50 and 70 Permits the taxpayer to value stock at cost, market selling value, replacement price, or to apply for a special valuation.

s70-60,65 and 55 These sections contain the provisions dealing with the valuation of livestock.

s70-85,90 and 95 Includes the value of trading stock in the taxpayer's assessable income where the stock was disposed of outside the ordinary course of the taxpayer's business.

s15-15 Taxes the profits of profit-making schemes using a profit-emerging system for accounting where the asset involved is not trading stock.(s15-15)

## **Cases**

R & D Holdings Pty Ltd v Deputy Commissioner of Taxation 2006 ATC 4472

All States Frozen Foods Pty Ltd v FCT 90 ATC 4175

Suttons Motors (Chullora) Wholesale Pty Ltd v FCT 82 ATC 4402

FCT v Raymor (NSW) Pty Ltd 90 ATC 4347

Investment and Merchant Finance Ltd v FCT (1971) Z ATR 361

FCT v St Hubert's Island Pty Ltd 78 ATC 4104

Kratzmans Hardware Pty Ltd v FCT 85 ATC 4138

Farnsworth v FCT (1949) 78 CLR 504

Australasian Jam Co. Pty Ltd v FCT (1953) 88 CLR 23

Philip Morris Ltd v FCT 79 ATC 4352

## **Discussion Questions:**

### **Question One**

Fitness Ltd sells fitness programs involving an advance purchase of 104 weekly floor classes and use of their gym for two years. The cost of the program is \$1240 and is paid in advance by customers. Their contract provides that they can obtain a pro rata refund for unused classes upon cancellation, but the company is entitled to deduct a \$200 cancellation fee. All payments received by the company are put in its Advanced Fees Account and \$200 per contract is immediately transferred to its General Account. Thereafter at the end of each month sums equivalent to the value of classes used are transferred to the General Account. During the tax year 2007/2008 Fitness receives payments of \$124,000. Of this, \$20,000 in cancellation fees and \$60,000 for classes used is transferred to its General Account. On 1 July 2008 a further \$1000 is transferred to General Account for classes used in June 2008.

Discuss Fitness' tax liability for 2007-2008.

Would your view alter if Fitness had no contractual obligation to give refunds but did so for goodwill?

What would be your advice if Fitness supplied exercise equipment in respect of which customers paid the full price up front but could request a refund within 30 days if not completely happy with the equipment?

### **Question Two**

Webster, Nicholls and Co is a public accounting partnership with eight partners, 15 employed salaried accountants and 20 support and secretarial staff. The partnership has offices in Brisbane, Townsville and Toowoomba. Although it is involved in some long-term projects, approximately 75% of turnover is represented by work taking less than three months to complete. Up to and including the year ended 30 June 2007, the partnership submitted its income tax returns on a cash received basis and the Commissioner assessed them on this basis but for the year ended 30 June 2008 plans to use accruals for the recognition of taxable income.

Your advice is sought on the following matters:

- (a) Must the Commissioner accept the altered basis for returning income? What are the relevant considerations?
- (b) For tax purposes, in which income year are fees that were earned but not received prior to 30 June 2007 regarded as having been derived?
- (c) What treatment should be adopted in respect of the value of work-in-progress (i.e. incomplete work) as at 30 June 2008?

### **Question Three**

Spivs Ltd is a retailer of discount furniture and electrical goods. It allows customers to either buy goods for cash or on a credit sales basis. Credit sales are payable over 12 months and bear interest at 18% per annum. As at 30 June 2008 the company received \$100,000 in cash sales. During the same period, it also entered into legally binding credit sales contracts worth \$200,000 on which only \$20,000 worth of deposits, \$15,000 worth of instalments, and \$3,500 in interest have been received.

Ignoring Spivs Ltd's operating expenses, advise the company as to its tax liability for the year ended 30 June 2008. Is it permissible for profits to be calculated on an emerging basis, as opposed to an accruals basis?

### **Question Four**

On 1 March 2007 Bag Construction Ltd conducts a deal with Cement Pty Ltd to construct a building for Cement's large storage needs.

The storage premises are to be completed by 31 March 2008 and the agreed contract price is \$3 million to be paid in the form of progress payments to be made monthly on the basis of percentage of completion less an 8% retention amount which will be paid only on completion and after a 6 month review of workmanship. Should any defects be discovered during the 6 months, the cost of repair will be deducted from the retention amount.

The \$3 million quoted for the project is based on a 20% profit margin. As at 30 June 2007 Bag had received \$441,600 representing invoices for the year as follows:

Cumulative % of completion		Date Invoice	Amount Invoice	Retention Record	Cash	Date Rec'd	Costs for Month
March	10%	6/4/07	300,000	24,000	276,000	8/4/07	200,000
April	15%	5/5/07	150,000	12,000	138,000	6/5/07	200,000
May	16%	3/6/07	30,000	2,400	27,600	4/6/07	20,000
June	18%	10/7/07	60,000	4,800	55,200	2/7/07	40,000
			540,000	43,200	496,800		

Assuming no other income or expenditure during the year, what is Bag's taxable income for 30 June 2007?

#### **Question Five**

John grows fruit on a commercial scale in the Goulburn Valley. He seeks your advice on the appropriate tax treatment in the following circumstances:

(a) How should he treat the value of ripe fruit at the end of the year of income?

(b) He received a deposit of \$5,000 from a fruit cannery for the supply of 10,000kg of fruit under a contract for "goods sold and delivered". The contract stipulated that the balance of the contract price of \$15,000 would be paid upon delivery of the fruit in good condition to its factory in Sydney. Industrial action by employees of the transport company resulted in the consigned fruit being help up in its warehouses (i.e. the transport company). Is this consignment "trading stock on hand"?

(c) Whether fruit delivered to a marketing authority at the end of the year of income can be treated as trading stock on hand.

Assumptions:

- (i) no payment has been received for the fruit,
- (ii) the sale has not been recorded as having been made in relation to his deliveries.

#### **Question Six**

a) Which of the following are trading stock on hand for the purposes of the Income Tax Assessment Act 1997? Explain and support your answers by reference to case law where applicable.

- i) Gravel belonging to a road making contractor
  - ii) A motor vehicle used by the owner of a user car sales business. The owner would sell the vehicle if he received an appropriate offer
  - iii) Fuel, oil and machine replacement parts stored by a manufacturer
  - iv) Component parts on order from Japan to be delivered one week after year end
  - v) A supply of small FM radios inscribed with the FM radio's logo, held for regular promotional "give-aways"
  - vi) A large supply of floppy disks used by a newspaper publisher. The disks are used by journalists to prepare copy.
- b) Which of the following costs would be included to arrive at a manufacturer's "cost" for the purpose of S70-45 of the Income Tax Assessment Act 1997. Support your answer by reference to case law and extrinsic material, if any.
- i) Factory manager's salary
  - ii) FBT applicable to the factory manager's remuneration package
  - iii) Factory foreman's wage
  - iv) Factory rates and taxes
  - v) Factory power and heating
  - vi) Interest on loans to fund the acquisition of the factory premises and plant
  - vii) Factory building repairs
  - viii) Factory plant repairs
  - ix) Product research and development costs
  - x) Product testing and quality control costs
  - xi) Factory plant and building depreciation (the depreciation for accounting purposes is different to that for income tax purposes)
  - xii) Raw materials storage costs
  - xiii) Finished goods warehousing costs
  - xiv) Factory, raw materials and finished goods insurance premiums
  - xv) Expenditure in dismantling used plant, scrapping it and repairing the floor area in readiness for the installation of the new replacement plant.
- c) Explain the options available to value trading stock at the end of a year of income.

### **Question Seven**

The Stack Group is undergoing a restructure of its manufacturing arm and plans to transfer finished goods stock from Stack (Aust) Pty Ltd to Pack (Aust) Pty Ltd a newly incorporated entity. Both Stack (Aust) Pty Ltd and Pack (Aust) Pty Ltd are owned, 100% by Stack Holdings Pty Ltd. As the Stack Group's adviser discuss the tax implications of the transfer of stock.

### **Question Eight**

a) If an item of trading stock held by a taxpayer is not disposed of, but ceases to be trading stock of that taxpayer after 1 July 2007, outline the tax consequences under the Income Tax Assessment Act 1997.

b) If an item which a taxpayer already owns changes in character so that the taxpayer starts to hold it as trading stock after 1 July 2007, outline the tax consequences under the Income Tax Assessment Act 1997.

## **WEEK SEVEN**

### **DEDUCTIONS AND TIMING ISSUES**

## **Background Reading:**

MTG Chapters 16 &17

We will look at the principles underlying the deductibility of expenditure in the ITAA building on an understanding that was obtained at undergraduate level. We will spend some time actually applying those procedures to fact situations and also examine the requirements of the substantiation provisions.

Topics are broken up into the following headings:

### **(i) Business Expenses**

#### **CASES**

Travelodge Papua New Guinea Ltd v Chief Collector of Taxes 85 ATC 4432

FC of T v Roberts

FC of T v Smith 92 ATC 4380

Wharf Properties Ltd v CIR ( Hong Kong ) 1997 BTC 173

Steele v FC of T 1999 ATC 4242

Commissioner of Taxation v Broken Hill Pty Company Ltd 2000 FCA 1431

Eastern Nitrogen Ltd v Federal Commissioner of Taxation 2001 ATC 4164

Federal Commissioner of Taxation v Payne 2001 ATC 4027

Federal Commissioner of Taxation v Anovoy 2001 ATC 4197

Amway v Commissioner of Taxation 2003 2003 FCA 1533

Guest v Fc of T 2007 ATC 4265

#### **RULINGS**

TR 95/25 Deductions for interest post Roberts and Smith Case

TR2003/D8 Deductibility of interest post Steele's Case

TR2003/4 Deduction denied where no business

### **(ii) Employment related expenses**

#### **CASES**

Day v FC of T 2007 FCAFC 193

### **(iii) Timing issues**

#### **CASES**

FC of T v James Flood (1953) 88 CLR 492

Nilsen Devpt Labs P/L v FC of T (1981) 144 CLR 616

FC of T v AGC Ltd 84 ATC 4642

Coles Myer Finance v FC of T 93 ATC 4214

FC of T v Energy Resources of Australia Ltd 96 ATC 4536

FC of T v CityLink Melbourne Ltd 2006 ATC 4404

#### **RULINGS**

TR 97/7 Meaning of " Incurred"

### **a) Prepaid Expenses:**

- b) **Bills of exchange and promissory notes:**
- c) **Provisions and Reserves**
- d) **Bad debt deduction:**
- e) **Relevance of Accounting Principles**
- f) **Non-Commercial Business Losses**

**Rulings:**

TR 94/25 & 26 Implications of Coles Myer Case  
 Taxation Ruling TR93/21 (Timing of deductions on commercial bills)  
 TR 2007/D1 Non-commercial Business Losses - Commissioner's Discretion

**Other Reading:**

Australian Accounting Standard 9

(iv) **Current and Capital Expense**

a) **The tests and their applicability**

Sun Newspapers Ltd v FCT (1938), 61 CLR 337  
Mt Isa Mines v FCT 92 ATC 4755  
National Australia Bank v FC of T 37 ATR Dec 1997  
Tyco Australia Pty Ltd v FC of T 2007 ATC 4799  
Star City Pty Ltd v FC of T 2007 ATC 5216

b) **Repairs and Improvements**

Taxation Ruling TR97/23 Deductions for repairs

c) **Depreciation**

Taxation Ruling TR2007/9 Atmosphere and Ambience at plant

(iv) **Substantiation of Expenses**

(v) **Black-Hole Expenditure**

(vi) **Debt Forgiveness provisions**

**Questions to be discussed**

**Question One**

In 2007, Moneylenders Inc., a moneylender, incurred very heavy losses and suspended operations for nearly a year. Finally its shares were sold to Investors Advances Ltd who commenced, through it, to lend money to farmers and graziers in June 2008. The name Moneylenders Inc. was changed to Investors (Loans) Advances Pty Ltd, and it changed its registered offices and place of business. You have been asked:

- (a) Are the losses of loan capital available as deductions?
- (b) Are amounts returned as income by Moneylenders Inc., on an accruals basis, in 2006 available to be written off by Investors (Loans) Advances Pty Ltd where borrowers have:
  - (i) made no payments since, or
  - (ii) been bankrupted or wound-up.

**Question Two**

Brass Bound Pty Ltd, an Australian private company, is a dealer in shares and non-ferrous metals. It is also a share trader and money-lender. In 2007 all shares in it were acquired by Boa Constrictor Inc. of Newark, New Jersey, USA, which lent Brass Bound Pty Ltd \$US5,000,000 unsecured (then worth \$A4,000,000). The loan was divided into a \$US3,000,000 loan to erect a head office for the company, and a \$US2,000,000 loan to obtain trading stock and shares. In 2008 when the loan was due for repayment Brass Bound found that as a result of an appreciation of the US dollar on the currency markets, the cost of repaying the entire loan had increased to \$A4,800,000.

Advise on tax treatment of the extra cost of repayment in US dollars if the loan is repaid.

**Question Three**

Meat Packers Ltd run an abattoir/killing works in a large seaport town. In 2005, because of a slump in overseas beef sales, they put their plant into "moth balls", retaining only a skeleton staff, but intending to re-open as soon as the export trade picked up. In July 2007, because of a shortage of suitable cattle, they decided to close down, keeping only a fund open for payment of industrial compensation to past workers who had claims against them.

Advise on the deductibility of their costs during 2007-2008 and any payments they make from the fund.

**Question Four**

Tortoise Coaches Inc., a New York based touring bus-company, retain a firm of consultants to investigate the feasibility of setting up in the travel business in Australia. After 18 months, and \$50,000 of study, the consultants advise them not to establish a travel service. Tortoise did invest funds in Australia and ask you to advise of the availability of the consultant's fees as a deduction against local income in 2007. In 2008, notwithstanding the consultant's recommendations, they commence freight operations. Can they claim the fees?

What if Tortoise instead borrowed \$2million from an Australian bank to build a hotel in Australia? This is their first venture in Australia and first hotel activity. Would the interest on the loan be tax deductible?

**Question Five**

Dr Stooples spends \$35,000 in remodelling one room in his house and fitting it out as a surgery and operating room for minor surgery. He wants to claim the following expenses:

Building Costs	\$30,000
Steriliser, Instruments, Lighting	5,000
Furniture	2,000
Mortgage Interest (1/8 of \$8,000 - the house has 8 rooms)	1,000
House heating and light bill	800
Council Rates	1,200
Land Tax	650

**Advise**

Dr Stooples has a surgery in the City and an appointment at the Suburban General Hospital. He wants to claim travel expenses of 20,000km per year between his home and these places. What do you advise?

In the course of his occupation Dr Stooples entertains visiting surgeons and drug company representatives. He estimates he provides at least \$50 per week of liquor and entertainment for his professional contacts. Can he claim this?

He has taken out income insurance with the Friendly Insurance Co. at a premium rate of \$700 per annum. Is this deductible? Why?

### **Question Six**

Jane is employed as a sales representative for a cosmetics company and is required to travel around Sydney and regional NSW promoting the company's product. She has incurred the following expenditure in the year ended 30 June 2008:

\* Watch \$300

Jane purchased a new watch with an alarm to ensure she is on time for all her appointments and whilst travelling in regional NSW she can use it as an alarm clock. The watch is a trendy name brand in keeping with her image as a sales representative for a cosmetics company.

\* Suits \$1500

Jane purchased 3 suits to wear during her work time. She does not wear any of these items other than whilst at work.

\* Gloves \$100

For the cold winter weather in Regional NSW

\* Subscriptions \$150

Subscriptions to the cosmetics industry's monthly journal

\* Sunglasses \$ 300

Jane purchased special driving glasses to reduce glare whilst driving in the NSW outback/ long distances for her work.

\* Make-up \$500

Jane had to purchase the full range of her employer's make-up to use as a demo model and also for her own use as she is required to use only her employer's make-up brand.

\* Motor Vehicle

Jane uses her own vehicle a 2005 model 4.1 litre Ford Falcon Sedan for work purposes.

Her employer pays her 33c per kilometre for the use of the car and Jane travelled 22,000 work-related kilometres during the 2008 year.

The car cost \$30,000. Jane did keep a logbook of running costs and business kilometres and found business use was 95%.

\* Self-education Expenses

Jane enrolled in a Beauticians Course that would run over a three-year period, two nights a week. Jane elected to pay the 3year fee up-front.

**Advise Jane of any tax deductions she may be able to claim during the 2008 year. Also outline any substantiation requirements that may apply.**

**Question Seven**

During the 2008 year Tasman Ltd incurred the following expenditure;

- (1) On 1 November 2008 entertainment expenses associated with the launch of a new product- \$10,000.
- (2) Expenditure on a staff training seminar on "Motivation and Sales Psychology" - \$2,000.
- (3) Expenditure incurred during January 2008 on a Gymnasium attached to work premises- \$10,000.
- (4) Expenditure on meals provided in the executive dining room - \$6,000.

Advise Tasman what deductions they may claim for the year ended 30 June 2008.

**Question Eight**

X Pty Ltd runs an agency arranging promotional appearances by recognised television stars. Various companies use the agency to book the services of the television stars. When the services of a star are arranged, the agent for the star sends an invoice to X Pty Ltd. The terms of the contract provided that half the fee is to be payable within seven days of receipt of invoice and half within seven days of the appearance date. X Pty Ltd did not usually seek payment from its clients until after the appearance date. Its account requested the amount paid to the star plus 10% for arranging the appearance. On 30th June X Pty Ltd had paid out \$100,000 to arrange appearances that were to occur between 30 June and 1 August. This amount represented payments on receipt of invoice. It wishes to deduct the full amount it owes on the invoices.

Advise.

**Question Nine**

A taxpayer wished to deduct the following costs relating to his attendance at a conference in Toronto, Canada:

Airfare, hotel accommodation, taxis to and from airports and meals. The conference lasted six days. After the conference the taxpayer spent another two weeks in the Toronto area sightseeing. The taxpayer kept a diary of his attendance at the conference

- (a) One month after his return to Australia the taxpayer's briefcase was stolen. The diary was in the briefcase. What result follows?
- (b) Assume the diary had not been stolen. What expenses are deductible to the taxpayer?
- (c) Assume the taxpayer kept a record of his expenses, but retained no documentary evidence and prepared no diary. His employer reimbursed the taxpayer for his expenses based on the records he retained. What tax consequences follow?

### **Question Ten**

(i) Sand storage building

The company entered into a contract on 25 September 2007 for the erection of a special purpose building. Construction commenced on 10 October 2007 and was completed on 12 January 2008 when it was first used. The building was designed with a tensioned floor, which served to take the load from the walls, to allow the drainage of the sand stacks and to allow controlled reclaiming by gravitational feed to a loading conveyor. The walls were designed to allow the water in the wet sand to evaporate so that they could be extended as the sand stack height increased. The roof was mounted on extendable pylons to accommodate the changing height requirement. The building, excluding the reclaiming conveyor belt system, cost \$350,000 that included capitalising \$30,000 lease rent for temporary storage of dry clean sand during the construction phase. You note that when sand is first excavated it is passed over a washing and grisly bar system to remove soluble and physical impurities before being stacked where it dries for a period before being sold.

This conveyor belt system cost \$95,000.

(ii) Expenditure on leased administration building;

	\$
1 Aug 2007 demountable partitions	20,000
1 Aug 2007 structural alterations to reception area	22,000
1 Dec 2007 fluorescent lighting	5,000
1 Jan 2007 carpets	8,000

### **Required**

What deductions are available in respect of the expenditures referred to above?

### **Question Eleven**

Matrix Pty Ltd acquired a piece of machinery costing \$150,000, used for shrink-wrapping their product, on 1 January 2007. Matrix believed the machine to have an effective life of four years and claimed diminishing value depreciation on the machine.

On 30 June 2008 Matrix traded in the machine for a new model. Matrix was given \$100,000 for the old machine that was offset against the purchase price of a new machine costing \$ 350,000.

- (1) What are the taxation implications of these transactions?
- (2) To what extent would your advice have differed if the original machine is sold to a related company for \$ 20,000 on 30 June 2008?
- (3) What would you advise if the machine had been sold to an unrelated party for \$200,000?

### **Question Twelve**

Pop Pty Ltd owns a large hotel complex, including a golf club, on the Gold Coast which opened on 1 January 2008.

The accountant at Pop is unsure as to how a number of items are to be treated for taxation purposes for the year ended 30 June 2008 and have asked you to advise with respect to the following areas:

- 1) Surrounding footpaths completed on 1 December 2007. Cost \$ 26,000

2) Cascade waterfall installed outside the main entrance to the hotel. Cost \$ 28,000

3) Drains leading from the hotel to a nearby river. Cost \$ 30,000

4) Visitors may borrow golf clubs to play at the hotel golf course. Each set of clubs costs \$700. Some sets however are not returned and the \$250 deposit is kept by Pop.

5) Pop moved some poker machines and children's fun park activities from a hotel it owns in Noosa and installed them in their new hotel on the Gold Coast. During this process the following costs were incurred:

\* Demolition of false floor on which poker machines and fun park activities stood \$4000.

\* Dismantling of machines \$4000.

\* Freight \$8000.

\* Installation of a new false floor on which the machines now stand \$5500.

\* Electrical wiring of new premises \$ 10000.

\* Testing procedures re workability after relocation \$5000.

**Advise Pop of the depreciation and other tax implications of each item for the year ended 30 June 2008.**

### **Question Thirteen**

Discuss the distinction between deductible repairs and capital improvements, including capital gains tax implications of capital improvements.

### **Week 8**

#### **TAXATION OF TRUSTS & INCOME SPLITTING**

Regulatory Regime:

Division 6 of Pt. III of the Act (ss. 95-102) establishes the framework for the taxation of trusts and beneficiaries.

Sec 26(b) includes beneficial interest in income derived under any will, settlement, deed of gift or trust, in a taxpayer's assessable income.

**NOTE:** Prior to the commencement of this seminar, participants are expected to familiarise themselves with the following basic concepts relating to the law of trusts.

- the nature of a trust
- creation of a trust
- classes of trust
- types of trust

### **Background Reading**

MTG Chapter 6

## **Topics Covered:**

Taxation of trustees and beneficiaries

- (a) an overview of Div. 6
- (b) the concepts of Present Entitlement and Legal Disability
- (c) calculating the net income of a Trust Estate
- (d) CGT & Trust distributions.
- (e) trust losses

## **Case**

Richardson v Federal Commissioner of Taxation 2001 ATC 4621

## **Practice Statement**

PSLA 2005/1 Net Capital Gains and Trusts

## **DISCUSSION QUESTIONS FOR THIS WEEK**

### **QUESTION 1**

Rodney, an estate agent died on 30 June 2005. Under the terms of a trust created by his will, the income of his estate is to be divided 1/2 to his widow and 1/4 each to his son and daughter. On 30 June 2005, the son and daughter were aged 12 and 17 respectively. The will also provides that the widow and son are entitled to their shares absolutely, while the share for the daughter is to be accumulated until she attains the age of 21. Each child does not have an interest in the corpus of the estate and losses are to be met from future income. The trust incurred a tax loss in 2007 of \$8,000. During the year ended 30 June 2008, the receipts and payments of the trust were as follows:

<b>RECEIPTS</b>	<b>\$</b>	
Debenture interest	20,000	
Rent from office building	50,000	
Dividend (fully franked) from a resident public company	2,000	
<b>PAYMENTS</b>		
Wages to caretaker of office building	10,000	
Alterations and extensions to building completed 1.1.04	13,000	
Legal expenses (appeal against State Land Tax)	160	
Sundry repairs to rectify storm damage	1,200	
<b>OTHER INFORMATION</b>		
Son's wages from part time work	3,500	

## **REQUIRED:**

1. Determine the Trust Net Income for the year ended 30 June 2008.
2. Explain the basis on which the income will be assessed, quoting relevant sections of the Act.

## **QUESTION 2**

Is it possible for a trust estate's net income for tax purposes to differ from its net income for accounting purposes? If so, how?

## **QUESTION 3**

David is a beneficiary of Hammer Unit Trust. David holds 100 units in the Trust that he purchased on 1 December 1992 for \$15 each. On 1 June 2008 David received a non-assessable capital payment of \$3 on each unit in the trust being a repayment of capital. What are the capital gains tax implications to David of this non-assessable distribution?

## **QUESTION 4**

Box Family Trust has carry forward tax losses as at 30 June 2007 of \$300,000. Box Trust derives income and incurs expenses in its activities as a share trader.

Box Trust is a discretionary trust and all beneficiaries are members of the Box family.

During the year ended 30 June 2008 the Box Trust derived income from the sales of raincoats. Sales prior to 1 July 2007 were derived directly by John Box a beneficiary of the Box Trust.

**Are the beneficiaries of the Box Trust able to make use of carry forward losses as at June 2007 in the 2008 year and subsequent?**

## **QUESTION FIVE**

Box Unit Trust wants to carry on its activities through a company that requires the transfer of assets from the trust to a company.

What tax relief is available to the Box Trust and its beneficiaries in restructuring its business?  
What are the requirements and what are the consequences?

## **WEEK 9**

### **PARTNERSHIPS AND TAXATION OF PARTNERS**

#### **BACKGROUND READING:**

MTG Chapter 5  
MTG 30500-30960

#### **TOPICS COVERED**

- 1) Nature of a partnership
- 2) Taxation consequences of creation and dissolution of a partnership
- 3) Net income of a partnership
- 4) CGT issues relating to partnerships
- 5) Income Splitting-Personal Exertion Income/Personal Services Income Regime

#### **PRINCIPLE SECTIONS:**

Division 5 - ITAA (Sections 90-94)

**RULINGS:**

TR 94/8  
TR 95/25  
TR 2005/7 Partnerships and Partners Salaries

Cases:

FCT v Beville (1953) 5 AITR 458  
FCT v Roberts: FCT v Smith (1992) 23 ATR 494  
Poole v FCT (1970) 122 CLR 427  
Leonard v FCT (1919) 26 CLR 178  
FCT v Happ (1952) 5 AITR 290  
FC of T v Everett 80 ATC 4076  
Reynolds v Commissioner of State Taxation (WA)(1986) 17 ATR 987  
FC of T v Galland 84 ATC 489, 86 ATC 4885  
Case 6/97 ATC 141  
Crommelin v FC of T 98 ATC 4790  
Ryvitch v Deputy Federal Commissioner of Taxation 2001 ATC 4403

**Discussion Questions for this Week**

**Question 1**

Bill and Ben operate a flower business as partners. The partnership agreement provides that the profits or losses of the partnership should be divided equally after Ben, the active partner, receives a salary of \$60,000.

For the year ending 30 June 2008 the partnership made a profit of \$30,000 after the payment of Ben's salary.

- (1) Calculate the net partnership income and the distribution to partners for the year.
- (2) Suppose that the partnership made a loss of \$80,000 after the payment of Ben's Salary. Calculate the net partnership loss and the distribution to partners for the year.
- (3) Suppose that the net partnership loss is \$4,500 after payment of salaries to Bill and Ben of \$22,500 and \$12,000 respectively. Calculate the net partnership income/loss and the distribution to partners.

**Question 2**

Evans and Downing operate a legal practice as partners.

On 1 March 2008 they admitted a new partner into the partnership. The terms of the agreement provided that the profits of the partnership would be shared equally.

At 30 June 2008 the partnership accounts for the whole year revealed a profit of \$100,000.

**What are the tax consequences of the following?**

- (1) What is each partner's share of income from the partnership?
- (2) Because of a shortage of working capital, Evans made a loan of \$50,000 to the partnership on 1 May 2008. The interest on the loan was 15% p.a. How does this affect your answer to (1)?

- (3) Evans' wife Joanne is employed during the year of income as an accounts clerk/receptionist for the business. During the year she was paid \$25,000. The Commissioner disallowed \$5,000 of this under sec 26-35 of the *Income Tax Assessment Act*. Calculate the income of the partnership for the year, disregarding for this purpose the interest payments under (2) above.
- (4) On 1 June 2008 Evans assigned to his wife half of his share in the partnership for a consideration of \$20,000. How does this affect the taxation liability of Evans?
- (5) What if, instead of assigning half of Evan's share to his wife, the partnership took out a loan to repay 50% of Evan's capital contribution of \$50,000. Interest on the loan for 30 June 2008 is \$800.

### **Question 3**

Joe is a plumber who operates a business jointly with his wife, Merrilyn. For the year ended 30 June 2008, the business earned a taxable income of \$60,000. Merrilyn does all the accounts and ordering for the business but she does not do the banking and does not have authority to operate the bank account. From time to time, Joe makes withdrawals from the bank account and makes distributions of the income to Merrilyn and himself.

For the year ended 30 June 2008, Merrilyn received \$20,000 by way of distributions from the partnership and Joe received \$40,000.

Advise Joe and Merrilyn of the tax consequences of their business operations and their personal tax liability.

### **Question 4**

Peter Kingston was a partner in a large accountancy firm for 10 years. When he resigned from the partnership in October 1985, he received a payout of \$300,000 - \$250,000 for his interest in the partnership and \$50,000 for his written agreement not to approach any of the client he serviced in the partnership for a period of five years.

Kingston immediately entered into a new partnership with James Flinders. Their accounting partnership began on 1 November 1986, operating from leased premises. Each contributed \$5,000 as his initial capital in the partnership.

After only a few months the landlord indicated that the rental would be increased when the lease agreement expired on 30 January 1987. Kingston and Flinders decided it would be better to own their own premises. Flinders owned a commercial site that he had purchased as an investment on 10 August 1983 for \$200,000. The land was currently valued at \$300,000. This site appeared ideal and Kingston agreed to use the \$300,000 he received on "retirement" to fund the construction of the building on the land that would form part of their capital in the partnership. They called for tenders in February 1987, signed the contract in March 1987, and construction commenced in April 1987. The building was completed in October 1987, at a cost of \$300,000 and the partners, together with their staff of 10, immediately took occupancy.

In February 2008 the partners received an offer to buy the business premises for \$1m. A local real estate agent valued the premises at \$900,000 - the land at \$350,000 and the building \$550,000. Contracts for the sale at the \$1m price were signed on 10 March 2008 and settlement took place on 10 May 2008.

**Identify the taxation implications for Kingston and Flinders from these events.**

### **Question 5**

As a result of the death of his wealthy great-aunt, Jack inherits a substantial sum of money. He uses this money to purchase, on 1 July 1984, a liquor store and a hotel at the seaside resort of Happy Times on the famed Silver Coast for \$100,000.

On 15 April 1986, Jack enters into a partnership with his good friend Johnny Walker. Johnny pays Jack an amount of \$120,000 to acquire a half interest in the partnership. The market value of the bottle shop and hotel at the date of purchase are \$60,000 and \$180,000 respectively.

As business continues to boom, an additional partner, James Lee, purchases an equal interest in the partnership. He purchases his interest on 10 March 1987 for a consideration of \$100,000. The market value of the bottle shop and hotel at the date of purchase are \$75,000 and \$225,000 respectively.

On 2 February 2008, the partnership sold the hotel to a Japanese tourist who was passing through town for \$510,000.

(1) Advise the partnership and partners as to their income tax liability as a result of the above transactions.

(2) What if instead of selling the hotel on 2 February 2008 Johnny assigns 50% of his interest in the partnership to his spouse by way of gift? Assume the bottle shop is worth \$100,000.

### **WEEK 10**

#### **TAXATION OF COMPANIES AND SHAREHOLDERS**

**Background Reading:** MTG, Chapters 3 & 4

#### **Topics Covered:**

- (a) Company losses
- (b) The Imputation System
- (c) Liquidator's distributions
- (d) CGT issues relating to companies
- (e) S108, 109 and Division 7A
- (f) New Consolidation Rules

#### **Cases**

TelePacific v Federal Commissioner of Taxation 2005 ATC 4107 (Same- Business Test)

#### **DISCUSSION QUESTIONS**

##### **QUESTION 1**

You are required to prepare a franking account for the year ended 30 June 2007 for David's Pty Ltd, a resident Australian private company with 100% Australian resident shareholders, based on the following information:

- 30 June 2006 Carry forward Class C franking account balance \$50,000 credit
- 21 July 2006, instalment of 2007 tax \$90,000
- 21 October 2006, instalment of 2007 tax \$90,000
- 1 November 2006, dividend from Posh plc, a British subsidiary \$60,000

- 1 December 2006, tax payable on lodgement of return for 30 June 2006 \$50,000
- 30 January 2007, fully franked dividend paid \$ 500,000
- 31 January 2007, instalment of 2007 tax \$90,000
- 4 March 2007, received a fully franked dividend from Max Ltd \$80,000
- 20 March 2007, UK taxes paid in respect of a permanent establishment in the UK A\$15,000
- 21 April 2007, instalment of 2007 taxes \$90,000
- 15 May 2007, an amended assessment issued for the year ended 30 June 2000. Refund \$20,000
- 10 June 2007, 50% franked dividend received from Mask Pty Ltd a company which David's acquired during the year \$12,000

### **Additional Required**

**(1) What rebates, if any, would be available in respect of the information provided?**

**(2) Assume the shareholders in David's Pty Ltd are all non-residents. What implications would this have on their franking account and their ability to frank dividends?**

### **QUESTION 2**

Plus Pty Ltd has a franking account balance of nil as at 30 June 2007 and total franking credits of \$320,000 for the year ended 30 June 2007. Plus varied down it's 2007 3<sup>rd</sup> instalment of company tax on 1 July 2007 and received a refund of \$62,000.

**Do any penalty taxes arise from the variation of company tax on 1 July 2007?**

### **QUESTION 3**

Jeans Pty Ltd holds 80% of the shares in Blue Pty Ltd. Blue Pty Ltd holds 100% of the shares in Denim Pty Ltd. The ownership structure has been the same for the past 10 years.

Denim, which carries on the business of manufacturing jeans, has carry forward tax losses whilst Blue, which is the sales arm of the group, is quite profitable.

Jeans Pty Ltd acquired the balance of the shares in Blue on 1 January 2007 from an arms length seller.

### **Required**

- a) Can Denim transfer tax losses to Blue or Jeans?
- b) Discuss the operation of the continuity of ownership test and the same business test in respect of tax losses.
- c) What would be the advantages and disadvantages of Jeans, Blue and Denim electing to adopt the Consolidated tax regime?

### **QUESTION 4**

Master Investors Pty Ltd (MI) is an Australian resident private company that has a range of investments. Although they are an investment company all transactions are assumed to be on capital account.

**MI has asked your tax advice with respect to the following transaction:**

Distribution of \$10,000 cash from Aust Unit Trust.

The distribution advice contained the following information:

Distribution for the year ended 30 June 2008

- \* Franked dividend \$5,000  
(fully franked dividend)
- \* Australian sourced interest income \$3,000
- \* Tax deferred component (see note 1) \$1,500
- \* Tax free Division 43 component (see note 2) \$500

Note 1. Represents an accounting / tax difference that arose on calculation of the trusts assessable income due to tax depreciation rates on plant and equipment.

Note 2. Specifically relates to Division 43 write-off deduction allowed for tax purposes by the trust.

### **QUESTION 5**

James held 5000 shares in ABC Pty Ltd acquired for \$20,000 on 1 January 1991. On 1 January 2008 James received a notice from the liquidator of ABC that the company had been wound up with a distribution cheque for \$30,000. The distribution included \$5,000 paid as a franked dividend.

The \$30,000 represented a full and final distribution from ABC and James was advised that the distribution represented payments out of the following accounts:

Share capital \$5,000

Capital profits Reserve  
Pre CGT \$8,000  
Post CGT \$10,000  
Retained profits \$7,000 (\$5,000 franked)

The company was deregistered on 27 June 2008.

### **Required**

**Advise James on the tax treatment of the liquidation distributions.**

## **WEEK 11: INTERNATIONAL ASPECTS OF TAXATION**

### **Background Reading:**

MTG Chapter 21 and 22

### **Topics Covered:**

#### **(a) Interaction with double tax treaties (DTA's), the Residence and source rules:**

Income Tax (International Agreements) Act 1953 (as amended) s.4; also refer to the Schedule

of this legislation for examples of DTA's entered into by Australia.

**(b) Taxation of Foreign Source Income of Residents**

**(i) The Exemption System**

s23AF, 23AG, 23AH, 23AI, and 23AJ  
Temporary residents Division 768R

**(ii) Foreign Tax Credit System**

Div. 18 of Part III (ss. 160AE - 160AFF)

**(iii) Attribution of Income of Controlled Foreign Corporations & Foreign Investment Funds - Part X of ITAA (not addressed in detail but an overview of its operation)**

**(c) Taxation of Non-Residents**

ss.23(r), 128B, 128D, 254 and 255(ITAA 1936)  
Subdivisions 136A and B (ITAA1997)

**(d) Transfer Pricing**

Div. 13

**Case:**

W R Carpenter Holdings Pty Ltd & Anor v Federal Commissioner of Taxation 2006 ATC 4652

**Rulings:**

TR94/14 International Transfer Pricing: Basic concepts  
TD94/58 Exempt income under ss. 23AF and 23AG  
TR98/17 Residency  
TR99/11 International transfer pricing for intra-group services  
TR2004/15 Residence of Companies

**DISCUSSION QUESTIONS FOR THIS WEEK**

**QUESTION 1**

**Part A**

Bob, an Australian resident, derived the following income during the year ended 30 June 2008.

	\$AUD
Salary – Australia	40,000
Rental – US Property	10,000
Rental Outgoings – US Property	(12,000)
Interest received – UK (net of \$1,000 withholding tax)	9,000
Dividends – NZ (net of \$1,500 withholding tax)	8,500
Dividends – USA Public Company (net of \$300 withholding tax)	1,700
Business Profits – NZ	3,000
Interest paid – on funding of NZ share investment	(20,000)
Dividends Australia – Franked	30,000
Dividends Australia – Unfranked	18,000
Total	88,200

The New Zealand Company (NZ) distributed all its after tax profits to the sole shareholder BOB. NZ company tax is 33%.

Bob is also involved in a NZ business. He owns a factory in Wellington in NZ that makes jewellery sold mainly in NZ to tourists. Net profit was \$5,000 for the year ended 30 June 2008 and after NZ tax of \$2,000 was paid, Bob received a net \$3,000.

### Required

- a) Outline the factors to be taken into account when calculating taxable income, entitlements to foreign tax credits and tax payable. Also calculate Bob's taxable income, tax payable and determine Bob's entitlement to foreign tax credits, if any.
- b) Assume instead that the taxpayer is Bob Pty Ltd (BPL). Calculate the company's taxable income, tax payable and determine its entitlement, if any, to Australian foreign tax credits. (Assume that the \$40,000 salary derived by Bob is instead Australian business profits derived by BPL).
- c) In respect of Australian shares, NZ shares and the US rental property, what are the implications if either Bob or BPL was to become a non-resident of Australia.

### Part B

Alain is an Australian resident who is usually employed in France for four months of each year as a ski instructor. During the 2007/2008 financial year on his way back to Australia from France, Alain visited Africa and was subsequently employed by the government of a minor African nation in establishing a training program for its Winter Olympians. Alain was well rewarded by the African employer and received the equivalent of \$15,000 Australian dollars for one month's service. The African Government for which Alain worked does not tax salary and wage income and Alain retains the gross amount received.

Alain has a unit at Mount Buller, in Victoria, from which he derived gross rental \$3,250 over the summer 2007/2008. Deductible expenses incurred in deriving gross rental income amounted to \$4,200.

While employed in France, during December 2007 to March 2008, Alain received a salary, the equivalent of \$30,000, and paid the equivalent of \$5,000 in French tax. This compared favourably to the \$20,000 he earned from his employment as a ski instructor at Mount Buller in July, August and September 2007.

Alain's only deduction for the year ended 30 June 2008 was \$3,000 he spent on ski equipment in France on December 2007. Given the continual use of the ski equipment in Australia and overseas, Alain usually needs to replace it every two years.

In the year ended 30 June 2008, Alain worked four months in France, one in Africa and three in Australia. Alain usually spends the balance of the year working on his unit at Mount Buller or fishing.

During the 2007/2008 year Alain only derived French salary income. Also his Australian rental property made a net loss in that year.

All amounts are in Australian dollars.

### Required

- a) Could Alain offset the Australian rental property loss in 2007 against the 2007 French salary or could the loss be carried forward and offset against his 2008 income? Would it make any difference if Alain is a non-resident in both the 2007 and 2008 income tax years?
- b) Calculate Alain's 2008 taxable income and tax payable.

## **QUESTION 2**

Mr Wong, an Australian resident, has established a company in Singapore, with shares held on his behalf by a nominee in Singapore. To all intents and purposes the company is resident in Singapore. Mr Wong then arranged for his company to send containers of fast selling consumable goods to his other businesses in Australia. The Singapore company charges Mr Wong's Australian business an amount for the goods that involves a big mark-up and is more than what would have been otherwise paid if the goods had not first been sold through the Singapore company.

What might be the motives behind this arrangement and discuss the likely response by the ATO to this arrangement. How would your answer differ if the goods involved were computer software and licenses to use the software?

Assuming Mr Wong was attempting to charge a price to the Australian business that is "arms length" what arguments and documentation would he need to maintain? (See TR 98/11)

## **QUESTION 3**

Minitch Ltd. a Japanese microcomputer producer, wishes to market its product in Australia. The company is considering several alternative ways of introducing its computers to the Australian market and approaches you to advise on the Australian consequences of each of the following:

- (a) selling to an Australian importer
- (b) sending a representative from Japan on periodic selling trips to Australia;
- (c) appointing an Australian agent;
- (d) opening a branch office in Australia;
- (e) forming a wholly-owned Australian subsidiary.

## **QUESTION 4**

What is

- (1) A CFC?
- (2) A FIF?
- (3) The active income test?
- (4) Identify the "lists of countries" for the purposes of the CFC measures.

## **WEEK 12**

### **TAX ADMINISTRATION, ENFORCEMENT AND ANTI-AVOIDANCE**

#### **TAX ADMINISTRATION**

##### **Background Reading:**

MTG

Paragraphs 24-500 to 24580

Chapters 25, 28, and 29

##### **Part One**

- a) The Taxation Rulings Systems

Public Rulings

Schedule 1 Section 358 Taxation Administration Act

Private Rulings

Schedule 1 Section 359 Taxation Administration Act 1953

TR 92/1

TR 93/1

CTC Resources NL v (FCT) 94 ATC 4072

Payne v FCT 94 ATC 4191

Bellinz Case 1998

b) Self-Amendments S169A

c) The Penalty Regime

**The administrative penalty regime** is located in TAA Sch1 Pt 4-25 and provides for

1. failure to lodge penalty
2. shortfall amounts penalty
3. failure to meet various other tax obligations

See administrative penalty rate chart at MTG paragraph 29-000

In addition to an administrative penalty there may apply a **GIC amount** for late payment and **offences**.

d) Record keeping: Section 262 A

e) Objections & Appeal - Part IVC of the Tax Administration Act ("TAA")

Cases:

Trautwein v FC of T (No.1) 1936 56 CLR 63

FCT v Dalco 1990 ATC 4088.

**Part Two**

a) Tax Audits and Commissioner's Access Powers

S263, 264. ITAA

Allen, Allen & Hemsley v. DFCT (1989) 89 ATC 4294

Citibank v FCT (1989) 89 ATC 4268

Sharp v DFCT (1988) 88 ATC 4165

Industrial Equity Ltd v FCT (1990) 90 ATC 5008.

Dunkel v DcT (1990), 21 ATR 1279

Middencorp Electric Co Pty Ltd v Law Institute of Victoria & Amor 93 ATC 5041

May v FC of T 98 ATC 4960

FC of T v Coombes (No 2) 99 ATC 4634

FC of T v Pratt Holdings Pty Ltd & Anor 2003 ATC 4005

ATO's Access and Information Gathering Manual Revised in April 2005 and discussed in CCH Tax Week 2005 at 241

b) Obtaining Information from the Commissioner

Administrative Decisions (Judicial Review) Act 1977 (Ch.)

The Ombudsman Act (1976) Ch.

The Freedom of Information Act 1982 (Ch)

c) Recovery of Tax

TAA Sch 1 Subdiv 255-B

Taxation Ruling IT 2569: Extensions of Time to Pay under S206.

**ANTI-AVOIDANCE**

Background Reading: MTG 30000-30180

Part IVA Income Tax Assessment Act.

FCT v Peabody 94 ATC 4663

Osborne v FC of T 95 ATC 4323

Osborne v FC of T 95 ATC 4323

FCT v Spotless Services Ltd 96 ATC 5201

Esso Australia Resources Ltd v FC of T 1999 HCA 67

FCT v Metal Manufacturers Ltd (2001) 46 ATR 497

Hart v Federal Commissioner of Taxation 2004 ATC 4599

Cummins v Federal Commissioner of Taxation 2006 ATC 4084

**Questions for this week**

**QUESTION ONE**

- (a) In the course of preparing the income tax return for John Bonn you note that there is an element of doubt about the deductibility of a major repair and maintenance job on the rented property. John does not want to seek a private ruling. Outline to him the implications in relation to his exposure to possible penalties should his return be subject to a Tax Office audit.
- (b) Assuming John does lodge his return in accordance with your advice, including a request for a private ruling, what options are available to him should the response by the ATO be unfavourable?
- (c) The tax office auditor arrives at your office requesting all your tax files on John Bonn. The tax officer shows the appropriate authority. Are you required to hand over all your client's files? What avenues may you consider to avoid handing over to the tax office files in relation to this client?
- (d) John Bonn is interested in obtaining information on his case from the ATO. Advise John as to avenues he could pursue to obtain information on his income tax officers.
- (e) As a result of the audit by the ATO of John Bonn his assessable income for the year ended 30 June 2006 and 2007 is increased by 50,000 and 60,000 respectively. John advises you that he is unable to find this amount of money for at least 4 months. Advise John as to any options he may have to obtain an extension of time to pay.

**QUESTION TWO**

For several years Aitch has conducted a successful business manufacturing and marketing a deluxe line of Zeds. In 2006/2007 her taxable income from the business was \$160,000. Because she envisages the business expanding and profits increasing, Aitch seeks advice on minimising her income tax. She is single and has no dependants.

Aitch is advised that the business be sold to a company for its market value of \$1.4m and that the consideration be \$100 in shares and the balance by way of loan, repayable on demand with interest to be fixed from year to year by agreement. The company negotiates a bank overdraft to provide additional working capital.

The company will pay Aitch a salary of \$36,000 and the plan is to repay the loan to Aitch as additional private funds are required. To the extent that cash balances permit, a priority is the reduction of the bank overdraft and, until it is repaid, it is not intended to pay any interest to Aitch or declare any dividends.

**REQUIRED:**

- (a) Advise Aitch whether, in your opinion, S177F could be applied by the Commissioner. (You should disregard any possible capital gains tax consequences and must refer to relevant case law.)
- (b) Assuming the Commissioner does apply S177F and that an objection is disallowed, advise Aitch whether the matter should be referred to the Administrative Appeals Tribunal for review, or taken to the Federal Court.