Graduate Accounting and Commerce Centre

Faculty of Business and Economics

ACCG882

ADVANCED TAXATION

UNIT OUTLINE 2010

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 that 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.

Required texts and reading materials

Students must purchase:

2010 Australian Master Tax Guide CCH
2010 Core Tax Legislation and Study Guide CCH

Note:
(a) STUDENTS SHOULD ALWAYS BRING COPIES OF THE TAXATION LEGISLATION TO EACH WEEKLY SESSION.
(b) ONLY CURRENT LEGISLATION, TEXT AND CASEBOOK 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.

Other texts

Woellner, Barkoczy, Murphy and Evans "Australian Taxation Law" 20th Edition, CCH 2010 (Woellner)

Burgess, Cooper, Krever, Stewart and Vann “Income Taxation: Commentary and Materials” 6th Edition 2010 Thomson

Australian Master GST Guide 11th Edition 2010 CCH

Cooper and Evans “Cooper and Evans on CGT” 2010 Thomson

Case Study Texts

Coleman, Hart, Bondfield, McKercher, McLaren, Sadiq and Ting "Australian Tax Analysis: Cases, Commentary, Commercial Applications and Questions" 2010 7th Edition Thomson

Fisher and Hodgson “Tax Questions and Answers 2010” Thomson

Nethercott, Richardson and Devos "Australian Taxation Study Manual" 19th Edition CCH 2009

CCH Editors “Master Tax Examples” 8th Edition CCH 2010/10

Case Book

Stephen Barkoczy "Australian Tax Casebook" CCH 9th Edition 2009

Australian Taxation Law Cases” 2010 Thomson

Electronic Resources

The library research databases offer Tax and Accounting On-Line (Thomson) and CCH Online. These electronic resources include up-to-date discussions concerning income tax legislation, cases, rulings 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 includes a legal database from which you can download rulings and cases.

Seminars

The unit is made up of 12 weekly seminars each of three hours duration. There will be a minimum of formal lecturing and it is envisaged that the seminars will cover the specified topics through discussion of the questions 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.

Unit Assessment

The following weights will apply

In-Class test	10%
Assignment	30%
Final examination (open book)	60%
Total	**100%**

GENERAL NOTES ON ASSESSMENT PROCEDURES

- The final examination will be held on 1 June 2010 commencing at 6.00 p.m. It will be a 3 hour open book written examination plus 10 minutes reading time.
- Assignment due: 20 April 2010
  Estimated word length: 3000 words.
- In-class test 23 March 2010.
- Students are expected to participate in discussion each week.
- Assignment to be typed.
- Plagiarism will result in a zero mark
- **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.**
- **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).

For an explanation of the University policy on grading please refer to the Postgraduate Handbook

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		
Week	**Date**	**Seminar Topic**
1	23/2	Introduction
2	2/3	Capital/Income distinction, Carrying on business and
		Income from isolated transactions
3	9/3	Income from personal exertion
		Fringe Benefits Tax
4	16/3	Taxation of capital gains
5	23/3	In-class test
		Goods and Services Tax
6	30/3	Taxation of superannuation funds
		Derivation and trading stock
6/4 and 13/4 no class		
7	20/4	Deductions
		Assignment due
8	27/4	Taxation of Trusts and Beneficiaries
9	4/5	Partnerships and taxation of partners
10	11/5	Taxation of companies and shareholders
12	18/5	Tax administration, enforcement and anti-avoidance.
EXAM	1/6	

WEEK TWO

Capital/Income distinction, Income from business and income from isolated transactions.

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).

Knowledge Objectives:

After completing the background reading and discussion questions this week you should be able to:

- *Understand the relevant criteria that are applied to determine whether a taxpayer is carrying on a business and apply those criteria to a fact situation.*
- *Understand the significance of the income/capital distinction.*
- *Be familiar with the cases that are relevant in establishing whether a payment received by a taxpayer is income or capital in nature.*
- *Determine whether a payment received by a taxpayer is income or capital in nature.*
- *Determine whether a lump sum payment received is income from an isolated transaction and assessable under Section 6-1 ITAA 1997.*
- *Understand the types of ordinary income assessable in accordance with S6-1 ITAA1997.*

Background Reading:

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

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
Federal Commissioner of Taxation v Stone 2005 HCA 21
Spriggs v FC of T 2009 ATC 20109
Riddell v FC of T 2009 ATC 20109

Income from isolated transactions

Whitfords Beach Pty Ltd v FCT 83 ATC 4277
Kosciusko Thredbo P/L v FC of T 84 ATC 4043
FC of T v Merv Brown Pty Ltd 85 ATC 4080
Westfield Ltd v FCT 87 ATC 4234
FCT v Myer Emporium 87 ATC 4363
Memorex Pty Ltd v FC of T 87 ATC 5034
Cyclone Scaffolding Pty Ltd v FC of T 87 ATC 5083
GP International Pipecoaters P/L v FC of T 88 ATC 4823
FCT v Cooling 90 ATC 4472
FC of T v GKN Kwikform Services P/L 91 ATC 4336
Henry Jones (IXL) Ltd v FCT 91 ATC 4663
Hyteco Hiring Pty Ltd v FCT 92 ATC 4694
Lees and Leech Pty Ltd v FC of T 97 ATC 4407
Montgomery v FC of T 98 ATC 4120

Rulings:

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.

Required

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 for 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 2009 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.

Required

Assume that the contract went ahead as planned. Advise X Ltd on the tax treatment of receipts under the 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 1994 the property was worked as a citrus orchard. In September 1994 Mr Boodles suffered a coronary occlusion and was told by his medical advisers that he should not do any further manual work.

In January 1995, 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 2006. 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 2010 to December 2010.

The site and building works were completed by March 2010 and by December 2010 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.

Required

What are the tax consequences of the above stated project to Boodles.

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.

Required

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.

Required

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 overseas 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.

Required

During the year ended 30 June 2010 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

Required

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 ?

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.

Knowledge Objectives:

After completing the background reading and discussion questions this week you should be able to:

- *Understand the relevant criteria that are applied to determine whether a payment received by a taxpayer is assessable as income from personal exertion in accordance with Section 6-1 and apply those criteria to a fact situation.*
- *Be familiar with the cases that are relevant in establishing whether a payment received by a taxpayer is income from personal exertion.*
- *Understand and apply the FBTAA.*
- *Understand the application of and interrelationship between the ITAA and FBTAA to employee remuneration.*
- *Explain the application of Div 83A ITAA 1997 to employee share schemes.*

INCOME FROM PERSONAL EXERTION

Background Reading:

MTG Paragraphs
10-050 to 10-076
10-260 to 10-280
10-860 to 10-880

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
Roads & Traffic Authority of NSW v FC of T 93 ATC 4508
FCT v Holmes 1995 ATC
Payne v FC of T 96 ATC 4407
FCT v Rowe 97 ATC 4317
Dean & Anor v FC of T 97 ATC 4762

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 TR2001/1 Salary Sacrifice Arrangements

b) Payments for Service Contracts

Cases:

Dickenson v FC of T (1958) 98 CLR 460
Brent v FC of T 71 ATC 4195
Hepples v FC of T 91 ATC 4808
Dean & Anor v FC of T 97 ATC 4762

Rulings:

Income Tax Ruling TR 95/3 (see above)

c) Employee Share Acquisition Schemes ("ESAS")

Background Reading:

MTG 10-080 to 10-096

Relevant Sections:

Div 83A ITAA1997

d) Fringe Benefits Tax

Background Reading:

Master Tax Guide Chapter 35

e) Personal Service Business

Background Reading:

MTG 30-600-30690

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 2010, Staedler won a tender contract to install a new computer system for EZI Ltd located in Singapore. As a result, on 1 April 2010, 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 moving permanently to Singapore, Fiona 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 2010.

Required

Advise Parsons as to the assessability of the above amounts in Australia for the years 2009 and 2010.

<u>Question Two</u>

Abbey Jones was employed by Block Publishing as the marketing manager commencing 1 July 2009. His employment contract included the following forms of remuneration;

1) Salary $150,000 pa

2) Superannuation contributions to Block Publishing Superannuation Fund $10,000 pa

3) Entertainment allowance $3,000 (GST Inclusive) pa

4) Telephone rental and charges up to maximum of $1,500(GST Inclusive) pa

5) Motor vehicle provided
   Cost to Block Publishing $63,000(GST inclusive)
   Total travel for the year 8,000 km
   50% private usage
   No log-book was maintained

6) Car parking fees paid - $16.00(GST inclusive) a day in Kings Parking Station

7) Interest free loan of $100000 to Abbey commencing 1 July 2009. Abbey plans to put the money towards the purchase of a principle residence.

8) Lap-top computer provided for use at home. Cost $3,000(GST inclusive)

9) On 1 July 2009 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 2009 $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(GST inclusive). Block Publishing also paid the cost of airfares for Abbey to fly from Melbourne to Sydney - $600(GST inclusive).

11) Abbey was paid $5,000 for entering into a confidentiality agreement with Block Publishing on commencement of employment. Abbey received a further $8,000 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 previously received $1500 pa for representations in that capacity.

13) Abbey attended a conference in Los Angeles between 20 and 27 June 2010. The conference titled "Marketing Strategies for the Future" 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 dairy and all records as requested by Block Publishing. The costs in relation to the trip and reimbursed by Block publishing were as follows:

Airfares	$4000
Conference fees	$2000
Accommodation	$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 well as a trophy which sits on his office desk.

15) 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 2010 worth $880(GST inclusive). 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 income tax and fringe benefits tax implications to Block Publishing and Abbey in respect of the above stated items?

Question Three (extra practice question)

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

1) **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.**

2) **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

Knowledge Objectives:

After completing the background reading and discussion questions this week you should be able to:

- *Understand the definition of a CGT asset.*
- *Identify the various CGT events.*
- *Determine the cost base, reduced cost base and capital proceeds.*
- *Apply the methodology used to calculate a net capital gain or loss.*
- *Identify the various types of CGT assets.*
- *Apply the discount method or indexation method where relevant.*
- *Apply the CGT exemptions.*
- *Explain the small business CGT concessions.*
- *Determine the CGT consequences of death.*
- *Identify and apply the CGT anti-avoidance provisions.*
- *Identify whether rollover relief is available on restructure.*

<u>Background Reading:</u>

MTG Chapter 12
MTG paragraphs
13-000 to 13-300
13-720 to 13-730
13-570 to 13-590
13-870

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

(ii) Cost base, reduced cost base and consideration

(iii) Calculation of Gains & Losses

(iv) Exemptions

(v) Roll-over Relief

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

<u>Discussion Questions</u>

<u>Question One</u>

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 obtained a valuation of the property. The valuer advised that the total value of the property was $700,000 (market value of the land was $400,000 and the house was $300,000) as at 15 May 2010.

Marc entered into a contract to sell the land and house to Luca on 20 June 2010 for $640,000 cash. Luca also gave Marc a car valued at $50,000 as consideration for the purchase of the car.The sale was settled on 1 August 2010.

Marc also sold the following parcels of shares during the year ended 30 June 2010:

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 share issue on 1 Sept 1989 (m. value at that date $10). Sold 1 July 2009 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 2009 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 2009 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 for the year (shares were purchased for the purpose of resale)

- 3000 MIM shares (purchased 2 August 2008 for $3 each), sold on 4 November 2009 for $5 each. Brokerage was $100 on purchase and $200 on sale.

<u>Required</u>

1) **Assuming Marc derived no other income calculate Marc's taxable income and tax payable for 30 June 2010.**

2) **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.**

<u>Question Two</u>

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 and 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 20 years Sally and her two grandchildren, Bill and Ben, spent many joyous times down at their holiday house. Suddenly, in January 2010, 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 2010 they sold the holiday house with the adjoining tennis court for $400,000.

Required

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

2) **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?**

<u>Question Three</u>

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 2009 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%

Required

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

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

<u>Question Four</u>

Consider the following unrelated transactions during the year ended 30 June 2010.

(i) In August 1986 A (a resident) acquired a canteen of Victorian cutlery 1891 for $3,000. In May 2010 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 2006 (market value $A1m) at which time she is transferred to her employer's Australian office. In January 2010 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.

Required

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

<u>Question Five</u>

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	10,000
	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 2010, 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.

Required

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

2) **What would be your advice to Jan Chan, if on 5 March 2010 she sold her business (set up on 1 June 1991) 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 2009 of $100,000 and one asset acquired in 1991 with a cost base of $250,000 and a market value as at 1 July 2009 of $800,000.

On 1 July 2009 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.

Required

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"

Knowledge Objectives:

After completing the background reading and discussion questions this week you should be able to:

- *be able to explain the interaction between the GST provisions and other taxes*
- *have a basic understanding of the mechanics of the GST*
- *develop an awareness of the GST issues for business*
- *be able to identify the GST implications arising from certain transactions*

<u>Background Reading:</u>

Master Tax Guide Chapter 34

<u>QUESTION ONE</u>

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.

Required

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 2009 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?

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

2) **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?**

3) **Paul entered into a contract to sell his business on 1 December 2009. The assets transferred on sale of the business by Paul on 1 December 2009 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?

<u>QUESTION TWO</u>

Joseph has been working on the GST calculations for the purposes of preparing SAW's Business Activity Statement for the month ending 30 June 2010 and is unsure of the GST implications of the following transactions:

1) Total entertainment expenses incurred during the month of June 2009 were $8,800 (GST inclusive). Total entertainment expenses include deductible entertainment expense of $2,100 (GST inclusive).

2) A new timber cutting machine was purchased by SAW that was delivered and invoiced on 10 June 2009. The cost of the machine was $27,500 (GST inclusive). The cost of the machine is claimed as depreciation for income tax purposes over its effective life.

3) Costs of $660 (GST inclusive) associated with the maintenance of a residential property located on business premises. The caretaker resides in the premises and SAW charges the caretaker a nominal rental fee of $150 per week.

4) Legal expenses of $10,100 (GST inclusive) associated with the issue of ordinary shares by SAW.
5) Legal expenses of $6,600 (GST inclusive) associated with the sale of SAW's transport division on 2 June 2009. The sale of the transport division constituted the sale of a going concern and was GST-free.

Required

Explain to Joseph the GST implications of the above-stated expenses incurred by SAW.

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

TAXATION OF SUPERANNUATION FUNDS

Knowledge Objectives:

After completing the background reading and discussion questions this week you should be able to:

- *Identify the types of receipts assessable to a complying superannuation fund.*
- *Identify the types of payments deductible to a complying superannuation fund.*
- *Identify the types of receipts that are exempt if derived by a complying superannuation fund.*
- *Calculate taxable income and tax payable for a complying superannuation fund.*

- *Understanding the meaning of derived for the purposes of the ITAA 1997.*
- *Determine the point at which ordinary assessable income is derived.*
- *Value trading stock using one of the acceptable methods.*
- *Understand and apply the sections in Divison 70 ITAA1997 to trading stock.*

Background Reading:

MTG
8-010 to 8-350

Question One

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 2010:

		$
Revenue		
Income from a pooled superannuation trust		54,000
Contributions by the Z Group of Companies on behalf of their employees, based on 9% of their normal salary		55,000
Compulsory contributions from members (Salary Sacrifice)		8,000
Voluntary contributions from members		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 2009		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 fund's 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 2010, 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 use to eliminate a 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
9-000 to 9-120
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

<u>Henderson v FC of T 70 ATC 4016</u>
<u>Cardens Case (1938) 63 CLR 103</u>
<u>FC of T v Firstenberg 76 ATC 4141</u>
<u>Barratt v FC of T 92 ATC 4275</u>
<u>Dormer v FCT (2002) 51 ATR 353</u>
TR 98/1 Determination of income; receipts v's earnings

e) Changing Accounting Method

<u>Country Magazine v FC of T (1968)</u> 117 CLR 162
<u>Henderson v FC of T 70</u> ATC 4016

<u>**2.Trading Stock**</u>

MTG 9-150 to 9-300

<u>Principal Sections:</u>

Division 70 ITAA1997

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

Investment and Merchant Finance Ltd v FCT (1971) Z ATR 361
Philip Morris Ltd v FCT 79 ATC 4352
Suttons Motors (Chullora) Wholesale Pty Ltd v FCT 82 ATC 4402
All States Frozen Foods Pty Ltd v FCT 90 ATC 4175
FCT v Raymor (NSW) Pty Ltd 90 ATC 4347

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 2009/2010 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 2010 a further $1000 is transferred to General Account for classes used in June 2010.

Required

Discuss Fitness' tax liability for 2009-2010.

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 2009, 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 2010 plans to use accruals for the recognition of taxable income.

Required

Your advice is sought on the following matters:

1) **Must the Commissioner accept the altered basis for returning income? What are the relevant considerations?**

2) **For tax purposes, in which income year are fees that were earned but not received prior to 30 June 2009 regarded as having been derived?**

3) **What treatment should be adopted in respect of the value of work-in-progress (i.e. incomplete work) as at 30 June 2010?**

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 2010 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 2010. Is it permissible for profits to be calculated on an emerging basis, as opposed to an accruals basis?

Question Four

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

1) **How should he treat the value of ripe fruit at the end of the year of income?**

2) **John 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"?**

3) . 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 Five

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.

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.

Explain the options available to value trading stock at the end of a year of income.

<u>Question Six</u>

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.

Required

As the Stack Group's adviser discuss the tax implications of the transfer of stock.

<u>Question Seven</u>

Required

1) **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 2010, outline the tax consequences under the Income Tax Assessment Act 1997.**

2) **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 2010, outline the tax consequences under the Income Tax Assessment Act 1997.**

WEEK SEVEN

DEDUCTIONS AND TIMING ISSUES

Knowledge Objectives:

After completing the background reading and discussion questions this week you should be able to:

- *Explain and apply the principles underlying the general deduction for expenditure incurred in accordance with Section 8-1 ITAA1997*
- *Be familiar with and apply the specific deduction sections in the ITAA1936 and 1997.*
- *Be familiar with and apply the depreciation provisions in Division 40 ITAA1997.*
- *Be familiar with and apply the capital works allowance in Division 43 ITAA1997.*
- *Explain how any deductible amounts are calculated and the point at which the deduction is available.*
- *Explain the significance of the substantiation requirements in determining an entitlement to a deduction.*

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
Riddell V FC of T 2009 ATC 20-109
Spriggs v FC of T 2009 ATC 20-109

(ii) **Employment related expenses**

(iii) **Timing issues**

- **Prepaid Expenses:**
- **Bills of exchange and promissory notes:**
- **Provisions and Reserves**
- **Bad debt deduction**:
- **Relevance of Accounting Principles**
- **Non-Commercial Business Losses**

CASES

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
FC of T v Malouf 2009 ATC 20-099

RULINGS

TR 97/7 Meaning of "Incurred"

(iv) **Current and Capital Expense**

- **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 2009 ATC 20-093

- **Repairs and Improvements**

Taxation Ruling TR97/23 Deductions for repairs

- **Depreciation**

- **Black-Hole Expenditure**

(v) **Substantiation of Expenses**

Questions to be discussed

Question One

In 2008, 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 2009. 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:

Required

1) **Are the losses of loan capital available as deductions?**
2) **Are amounts returned as income by Moneylenders Inc., on an accruals basis, in 2008 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

Meat Packers Ltd run an abattoir/killing works in a large seaport town. In 2007, 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 2009, 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.

Required

Advise on the deductibility of their costs during 2009-2010 and any payments they make from the fund.

Question Three

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 2009. In 2010, notwithstanding the consultant's recommendations, they commence freight operations.

Required

Can Tortoise claim the fees as an income tax deduction?

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 Four

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

Required

1) **Advise Dr Stooples as to the deductibility of the above stated expenses.**

2) **Dr Stooples has a surgery in the City and 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?**

3) **In the course of his occupation Dr Stooples entertains visiting surgeons and drug company representatives. He estimates he spends at least $50 per week on liquor and entertainment for his professional contacts. Can he claim these expenses as a tax deduction?**

4) **Dr Stooples has taken out income insurance with the Friendly Insurance Co. at a premium rate of $700 per annum. Is this deductible? Why?**

Question Five

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 2010:

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 2009 year. The car cost $39,000. 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.

Required

Advise Jane of any tax deductions she may be able to claim during the 2010 year. Also outline any substantiation requirements that may apply.

Question Six

During the 2010 year Tasman Ltd incurred the following expenditure;

(1) On 1 November 2010 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 2010 on a Gymnasium attached to work premises- $10,000.

(4) Expenditure on meals provided in the executive dining room - $6,000.

Required

Advise Tasman what deductions they may claim for the year ended 30 June 2010.

Question Seven

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 to the star within seven days of receipt of invoice and the other half within seven days of the appearance date. X Pty Ltd did not usually seek payment from its own 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.

Required

Is the full amount of invoice received by X Pty Ltd deductible under Section 8-1 ITAA 1997 as at 30 June or is the tax deduction limited to the actual 50% paid by 30 June? Please explain your answer with respect to relevant cases.

Question Eight

A taxpayer wished to claim a tax deduction for costs relating to attendance at a conference in Toronto, Canada including airfare, hotel accommodation, taxis to and from airports and meals.

The conference lasted six days and following the conference the taxpayer spent another two weeks in the Toronto area sightseeing. The taxpayer kept a diary of attendance at the conference

Required

1). **What expenses relating to the conference are deductible to the taxpayer?**

2). **One month after his return to Australia the taxpayer's briefcase was stolen. The travel diary was in the briefcase and the taxpayer seeks your advice as to what costs relating to the conference as deductible under Section 8-1 ITAA 1997?**

3). 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 Nine

(i) Sand storage building

The company entered into a contract on 25 September 2009 for the erection of a special purpose building. Construction commenced on 10 October 2009 and was completed on 12 January 2010 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 2009 demountable partitions	20,000	
1 Aug 2009 structural alterations to reception area	22,000	
1 Dec 2009 fluorescent lighting		5,000
1 Jan 2009 carpets	8,000	

Required

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

Question Ten

Matrix Pty Ltd acquired a piece of machinery costing $150,000, used for shrink-wrapping their product, on 1 January 2009. Matrix believed the machine to have an effective life of four years and claimed diminishing value depreciation on the machine.

On 30 June 2010 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.

Required

(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 2010?

(3) What would you advise if the machine had been sold to an unrelated party for $200,000?

Question Eleven

Pop Pty Ltd owns a large hotel complex, including a golf club, on the Gold Coast which opened on 1 January 2010.

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 2010 and have asked you to advise with respect to the following areas:

1) Surrounding footpaths completed on 1 December 2009. 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.

Required

Explain the depreciation and any other tax implications of each of the above stated items for the year ended 30 June 2010.

Question Twelve

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

WEEK 8

TAXATION OF TRUSTS

Knowledge Objectives:

After completing the background reading and discussion questions this week you should be able to:

- *Understand the taxation laws that relate to trusts.*
- *Outline the concept of a trust and the tax treatment of trustees and beneficiaries.*
- *Calculate net income of a trust.*
- *Understand the issues relating to any discrepancy between the cash income of a trust and the net income for tax purposes.*
- *Explain how CGT event E4 may apply to a distribution from a unit trust.*
- *Outline in general terms the application of the trust loss provisions to a family trust.*
- *CGT rollover relief available on transferring trust assets to a company.*
- *Outline the relative merits of different types of entities as tax planning vehicles.*

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 the seminar participants are expected to be familiar with the following
concepts that relate to the law of trusts:

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

Background Reading

MTG paragraphs
6-000 to 6-268

Topics Covered:

- Taxation of trustees and beneficiaries
- Overview of Div. 6
- Concept of present entitlement and legal disability
- Calculate net income of a trust estate
- CGT & trust distributions
- Trust losses

CASE:

Bamford & Ors V FC of T 2009 ATC 20-105

DISCUSSION QUESTIONS

QUESTION 1

Rodney, an estate agent died on 30 June 2007. 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 2007, 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 2009 of $8,000.

During the year ended 30 June 2010, the receipts and payments of the trust were as follows:

RECEIPTS	**$**
Debenture interest	20,000
Rent from office building	50,000
Dividend (fully franked) from a resident public company	2,000
PAYMENTS	
Wages to caretaker of office building	10,000
Alterations and extensions to building (completed 1.1.08)	13,000
Legal expenses (appeal against State Land Tax)	160
Sundry repairs to rectify storm damage	1,200
OTHER INFORMATION	
Son's wages from part time work	3,500

Required

1) **Determine the trust net income for the year ended 30 June 2010.**
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? Please explain your answer.

QUESTION 3

David is a beneficiary of Hammer Unit Trust. David holds 100 units in the Trust that he purchased on 1 December 1996 for $15 each. On 1 June 2010 David received a non-assessable capital payment of $3 on each unit in the trust being a repayment of capital.

Required

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 2009 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 2010 the Box Trust derived income from the sales of raincoats. Sales prior to 1 July 2009 were derived directly by John Box a beneficiary of the Box Trust.

Required

Are the beneficiaries of the Box Trust able to make use of carry forward losses as at June 2009 in the 2010 year and subsequent?

QUESTION 5

Box Unit Trust wants to carry on its activities through a company rather than a trust and is concerned that this would require the transfer of assets from the Box Unit Trust to a company.

Required

What tax relief is available to the Box Unit Trust and its beneficiaries in restructuring its business from a trust to a company? Please explain the requirements and consequences of any tax relief you identify?

WEEK 9

PARTNERSHIPS AND TAXATION OF PARTNERS

Knowledge Objectives:

After completing the background reading and discussion questions this week you should be able to:

- *Explain and apply the definition of a partnership under general law and the ITAA1997*
- *Understand the taxation laws that relate to partnerships.*
- *Outline the concept of a partnership and the tax treatment of partners.*
- *Calculate net income of a partnership.*
- *Understand and apply the CGT provisions to the partnership assets and assignment of a partnership interest.*
- *CGT rollover relief available on transferring partnership assets to a company.*
- *Outline the relative merits of different types of entities as tax planning vehicles.*

BACKGROUND READING:

MTG Chapter 5
MTG 30-500 to 30-960

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 Roberts: FCT v Smith (1992) 23 ATR 494
FC of T v Everett 80 ATC 4076

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 2010 the partnership made a profit of $30,000 after the payment of Ben's salary.

Required

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 2010 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 2010 the partnership accounts for the whole year revealed a profit of $100,000.

Required

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 2010. 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 partnership and during the year she paid $25,000. The Commissioner disallowed $5,000 of this amount under sec 26-35 of the *Income Tax Assessment Act.* Calculate the income of the partnership for the year, disregarding the interest payments under (2) above.**

4) **On 1 June 2010 Evans assigned to his wife half of his share in the partnership for consideration of $20,000. How does this affect the taxation liability of Evans?**

5) **What are the tax implications 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 2010 is $800.**

<u>Question 3</u>

Joe is a plumber who operates a business jointly with his wife, Merrilyn. For the year ended 30 June 2010 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 2010 Merrilyn received $20,000 by way of distributions from the partnership and Joe received $40,000.

Required

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

<u>Question 4</u>

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 2010 the partners received an offer to buy the business premises for $1.5m. A local real estate agent valued the premises at $1,500,000 - the land at $950,000 and the building $550,000. Contracts for the sale at the $1.5m price were signed on 10 March 2010 and settlement took place on 10 May 2010.

Required

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

<u>Question 5</u>

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 2010, the partnership sold the hotel to a Japanese tourist who was passing through town for $910,000.

Required

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 2010 Johnny assigns 50% of his interest in the partnership to his spouse by way of gift? Assume the bottle shop is worth $100,000.**

<u>WEEK 10</u>

<u>TAXATION OF COMPANIES AND SHAREHOLDERS</u>

<u>Knowledge Objectives:</u>

After completing the background reading and discussion questions this week you should be able to:

- *Understand the difference between a private and a public company for the purposes of the ITAA.*
- *Outline the criteria used in calculating a company's taxable income and the tax payable*
- *thereon*
- *Explain how corporate distributions are assessed.*
- *Prepare a franking account and know the implications for shareholders receiving dividends.*
- *Explain and apply the rules relating to the carry forward of company tax losses.*
- *Understand and determine the tax treatment of liquidation distributions.*

Background Reading:

MTG
Paragraphs
3-000 to 3-135

Chapter 4

Topics Covered:

(a) Company losses
(b) The Imputation System
(c) Liquidator's distributions

DISCUSSION QUESTIONS

QUESTION 1

You are required to prepare a franking account for the year ended 30 June 2010 for David's Pty Ltd, a resident Australian private company with 100% Australian resident shareholders, based on the following information:

- 30 June 2009 Carry forward Class C franking account balance $50,000 credit
- 21 July 2009, instalment of 2010 tax $90,000
- 21 October 2009, instalment of 2010 tax $90,000
- 1 November 2009, dividend from Posh plc, a British subsidiary $60,000
- 1 December 2009, tax payable on lodgement of return for 30 June 2009 $50,000
- 30 January 2010, fully franked dividend paid $ 500,000
- 31 January 2010, instalment of 2010 tax $90,000
- 4 March 2010, received a fully franked dividend from Max Ltd $80,000
- 20 March 2010, UK taxes paid in respect of a permanent establishment in the UK A$15,000
- 21 April 2010, instalment of 2010 taxes $90,000
- 15 May 2010, an amended assessment issued for the year ended 30 June 2006. Refund $20,000
- 10 June 2010, 50% franked dividend received from Mask Pty Ltd a company which David's acquired during the year $12,000

Additional Required

Assume all shareholders in David's Pty Ltd are non-resident for tax purposes. What implications would this have on the franking account and the ability to frank dividends?

QUESTION 2

Plus Pty Ltd has a franking account balance of nil as at 30 June 2010 and total franking credits of $320,000 for the year ended 30 June 2010. Plus varied down the 2010 3rd instalment of company tax on 1 July 2010 and received a refund of $62,000.

Required

Do any penalty taxes arise as a result of the variation of company tax on 1 July 2010?

QUESTION 3

Jeans Pty Ltd holds 80% of the shares in Blue Pty Ltd. Blue Pty Ltd owns 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 2010 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.

Required

MI has asked your advice with respect to tax implications of the receipt of a $10,000 cash distribution Aust Unit Trust. The distribution advice contained the following information:

Distribution for the year ended 30 June 2010

- **Franked dividend $5,000 (fully franked dividend)**

- **Australian sourced interest income $3,000**

- **Tax deferred component $1,500 (represents an accounting / tax difference that arose on calculation of the trusts assessable income due to tax depreciation rates on plant and equipment).**

- **Tax free Division 43 component $500 (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 1994. On 1

January 2010 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 2010.

Required

Advise James on the tax treatment of the liquidation distributions.

WEEK 11: INTERNATIONAL ASPECTS OF TAXATION

Knowledge Objectives:

After completing the background reading and discussion questions this week you should be able to:

- *Explain the interaction of the Double Tax Agreements and the ITAA generally but specifically in determining the assessability of business profits.*
- *Apply the residence and source rules in the ITAA*
- *Determine whether an exemption applies to foreign sourced income.*
- *Apply the foreign tax offset provisions.*
- *Identify the purpose of the CFC rules and the general concepts underlying those provisions including CFC, active income and listed countries.*
- *Explain the rules that apply to temporary residents*

Background Reading:

MTG
Paragraphs
10-860 to 10-880
21-000 to 21-070
21-095 to 21-098
21-105 to 21-180
21-670 to 21-800
22-000 to 22-070
22-125 to 22-510

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 ITAA 1936
Temporary residents Division 768R

(ii) Foreign Tax Offsets

(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

(d) Transfer Pricing

Div. 13 ITAA 1936

Rulings:

TR98/17 Residency
TR99/11 International transfer pricing for intra-group services
TR2004/15 Residence of Companies

DISCUSSION QUESTIONS FOR THIS WEEK

QUESTION 1

	$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

Bob, an Australian resident, derived the following income during the year ended 30 June 2
Salary was derived from part time employment Bob has in Australia.
The New Zealand Company (NZ) distributed all it's 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 2010 and after NZ tax of $2,000 was paid, Bob received a net $3,000.

Required

1) **Outline the factors to be taken into account when calculating taxable income, entitlements to foreign tax offsets and tax payable. Also calculate Bob's taxable income, tax payable and determine Bob's entitlement to foreign tax credits, if any.**
2) **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 offsets. (Assume that the $40,000 salary derived by Bob is instead Australian business profits derived by BPL).**

3) **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.**

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.

Required

1) **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?**

2) **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

Minitech Ltd., a Japanese microcomputer producer, wishes to market its product in Australia.

Required

Minitech 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:

1) **selling to an Australian importer**
2) **sending a representative from Japan on periodic selling trips to Australia;**
3) **appointing an Australian agent;**
4) **opening a branch office in Australia;**
5) **forming a wholly-owned Australian subsidiary.**

<u>QUESTION 4</u>

Required

1) What is

- **a. A CFC?**
- **b. The active income test?**

2) Identify the "list of countries" for the purposes of the CFC measures.

WEEK 12

TAX ADMINISTRATION, ENFORCEMENT AND ANTI-AVOIDANCE

Knowledge Objectives:

After completing the background reading and discussion questions this week you should be able to:

- *Explain the tax ruling system.*
- *Explain the income tax penalty regime.*
- *Determine a taxpayer's right of objection and appeal. Students should be familiar with the avenues open to a taxpayer to contest an assessment and be able to explain the most appropriate course of action in the circumstances.*
- *Explain the Commissioner's rights to access and information*
- *Explain the taxpayer's rights to information and an extension of time to pay tax assessed*
- *General familiarity with the Anti-avoidance provisions in Part IVA ITAA1936*

Part One

a) The Taxation Rulings Systems

MTG
Paragraphs 24-500 to 24-580

b) The Penalty Regime

MTG
Chapter 29

d) Objections & Appeal - Part IVC TAA

MTG
Chapter 28

Part Two

a) Tax Audits and Commissioner's Access Powers

S263 and S264 ITAA1997

MTG
Paragraphs 25-200 to 25-240

b) Obtaining Information from the Commissioner

MTG
Paragraphs 28-060

c) Recovery of Tax

TAA Sch 1 Subdiv 255-B

MTG
Paragraphs 25-410

d) Anti-avoidance Part IVA ITAA1936

MTG
Paragraphs 30-000 to 30-180

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 2008 and 2009 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.