THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2016

PAPER 2.01 – AUSTRALIA OPTION

Suggested Solutions

PART A

Question 1

Interest Deductibility

Security is not relevant to the deductibility issue.

Purpose is relevant and needs to be assessed objectively, with regard to all the relevant circumstances.

Interest is still deductible even if interest exceeds the rent – negative gearing is allowed currently in Australia.

Excess interest deduction would only be a problem if it was set up to ensure that there will always be a negative balance – Fletcher; Ure.

Roof

Repairs vs. replacements.

Initial repair is not deductible.

Definition of repair (Western Suburbs Cinema).

Statutory Provision.

Gas Heater

Depreciation – identifying it and explaining how it works.

Statutory Provision and Wangarrata Woollen Mills Case.

If not depreciable, what happens?

Timing

Exchange not settlement is critical.

Exact date can determine entitlement to discount and in which year contract occurs, thus determining when CGT has to be paid.

GST on property sale

Sale of pre-existing residential premises is input taxed if the premises are real property to be used predominantly for residential purposes (s40-65).

If the purchaser is going to use the premises for non-residential purposes it is a taxable supply, where the margin method can be used such that the GST payable will be 1 /11 of the difference between the sale price and $800,000 being the acquisition price.

This can only be done if HB acquired using the margin method.

Question 2

Part 1

Rebecca Johnson

Grossed up income	100,000
Tax	Nil
Tax Offset	30,000
Refund	30,000

Tammy Fernandez

Grossed up income	100,000
Tax	47,000
Tax Offset	30,000
Tax due	17,000

Growth Co Pty Limited

Grossed up income	100,000
Tax	30,000
Tax Offset	30,000
Tax due/Refund	Nil

Franking Credit to the Franking Account on receipt of franked dividend.

Jack Law

No WHT and No income Tax (see s 128D ITAA 1936).

XYZ Super Fund

Grossed up income	100,000
Tax	15,000
Tax Offset	30,000
Refund	15,000

Part 2

To BGE

It will need to pay Franking Deficit Tax of roughly $6,000 to make up for the shortfall in tax paid to justify the fully franked dividend paid.

Can be set against future tax liabilities of the company.

So long as the company does not make the same error again, it should be a satisfactory outcome.

In other words for a company with on-going tax payable. FDT is only a timing matter but can be significant and should therefore be avoided.

However there can be penalties, which would be a permanent cost.

To shareholders

No adjustment of any kind need be made. The position as set out above remains for all the shareholders.

Once declared as fully franked, shareholders are entitled to proceed on that basis without any comeback against them if the company got it wrong.

However, if the company pays a penalty that payment does not generate a franking credit.

PART B

Question 3

Sale of Shares in Wesfarmers

Assume shares are held on capital account and not as revenue items which is reasonable having regard to the length of the holding.

These shares are not taxable Australian property under Div 855 ITAA 1997 because its assets are not mainly Australian real property.

Sale of Private Company Shares

Same assumption as above.

The shares are taxable Australian property because the company owns mainly real estate assets but only if 30,000 shares represent at least 10% of the company's total issued shares.

If so, the capital gain will be $24,000 with no discount and tax therefore at 30% being $7,200.

Real Estate

This asset is clearly taxable Australian property and subject to capital gains tax on sale.

The gain is $1.8 million.

There is no discount so the tax rate will be 30%. Tax will therefore be $540,000.

The Business

Plant and equipment is not subject to CGT but is subject to annual depreciation (or capital allowance) with a balancing charge applying if there is an excess of consideration on sale over the written down value.

Inventory is not subject to CGT, but where there is a sale outside the ordinary course of business a separate regime will render the proceeds assessable to ordinary income tax.

Remaining assets are sold as part of a business sale and are subject to CGT, as they are all assets used in carrying on an Australian business and as such are taxable Australian property.

Need to make an apportionment of the consideration based on the contract or broadly on principles of reasonableness.

All the above is subject to the Australia/PRC Double Tax Agreement which may have an impact.

Question 4

Part 1

FRS rules are much less complex than Australian rules.

FRS only applies to FRS resident payment to non-resident.

Australian rules can apply to broader range of payments .

FRS explicitly covers rent; Australian rules don’t.

Rates are different with uniform rates in the FRS but not in Australia.

Differential rate in FRS if deductible as opposed to non-deductible; Australia tackles this issue by a different mechanism.

FRS WHT is a final tax; not always the case under the Australian rules.

Part 2

Does not deal with what happens if there is an obligation to withhold but no withholding occurs; this is covered by Australian rules.

Does not deal with situations where payments are made to a resident but to an offshore bank account; Covered in Australia.

No exemptions provided for (see s128B(3) ITAA 1936).

Interface with income tax not considered (see s128D ITAA 1936).

Part 3

Australian rules need to be simplified.

Australian rules need to consider whether rent should be covered.

PART C

Question 5

Students are expected to distinguish GST free, input taxed and taxable supplies.

No GST included on the first 2 but 1/11 of the total consideration is GST in relation to taxable supplies.

Part 1

Nil – GST free as an education supply.

Part 2

1/11 of the consideration, i.e. $30.

Taxable supply as not part of an education supply and otherwise a taxable supply.

Part 3

Nil – GST free as a health supply.

Part 4

Nil – GST free as an export.

Part 5

Nil – GST as a going concern, provided everything necessary for the carrying on of the business is provided.

Part 6

Nil – The importation of anything that would have been GST free or input taxed, if it were a supply, is a non-taxable importation and is not subject to GST.

Part 7

Nil – input taxed, provided purchaser intends to use it as residential premises.

Part 8

$80,000 – taxable supply.

Question 6

Part 1

Identify the four critical elements for Part IVA to apply:

- Tax Scheme;
- Tax Benefit;
- Sole or dominant purpose of obtaining the tax benefit; and
- Commissioner makes a Part IVA determination.

Identify the critical elements for Division 165 to apply:

- Scheme;
- GST Benefit;
- Sole or dominant purpose was to get the GST benefit or principal effect was that the avoider got the GST benefit; and
- Commissioner makes relevant declaration under subdivision 165-B.

Main difference is the emphasis on effect as well as purpose in the GST legislation, but only largely on purpose in Part IVA.

In identifying purpose factors are broader under Div 165 than they are under PartIVA. The former refers to circumstances surrounding the scheme and any other relevant circumstances (see s165-15(1) (k) and (l). These matters do not feature in s 177D (2).

Consequently, it is arguably much easier to find avoidance under GST that under PartIVA.

Part 2

Beneficiaries who are presently entitled and not under a legal disability in respect of income are taxed on that income at their marginal rates.

Beneficiaries who are not presently entitled or who are in who are under a legal disability do not include trusting come in their assessable income. Rather, that income is taxed to the trustee at the highest marginal rate subject only to Div 6AA re minors.

Losses are preserved within the trust and carried forward for offset against future trust income. In other words losses are not funnelled through to beneficiaries in the way that partnership losses are funnelled through to the partners. In this respect trusts are more akin to companies than partnerships.

Part 3

A partnership of a general kind in Australia is taxed on a look through contrary bases, such that it is the partners who pay tax in respect of partnership income rather than the partnership as such.

Equally, losses flow-through to individual partners. This is fundamentally different to the way in which a company is taxed, where the interposed entity pays tax with the tax paid being imputed for the benefit of individual shareholders. Losses are also retained within the company.

Taxing partnerships in the same way as companies would be a huge change to the current position and would effectively defeat the use of partnerships in business enterprises where the flow-through effect was critical. Australia already taxes certain partnerships like companies (see, for example, limited partnerships), but this is unusual and can be problematic.

Question 7

The tax treatment dividends received by an Australian shareholder foreign resident will depend very much on the character of the Australian shareholder and the level shareholder.

Under s 768-5 (the former section 23 AJ) dividend received by Australian resident company in respect of a non-portfolio dividend from a foreign company would be treated as non-assessable non-exempt income subject only to the operation 23 AI.

Section 23 AI operate in circumstances where there was prior attribution under the CFC rules such that any subsequent dividend would itself be non-assessable non-exempt income so as to avoid double taxation.

In other circumstances e.g. portfolio dividends or dividends received by individuals the dividend receipt will often be subject to tax in Australia but a foreign Income Tax Offset under Division 770 may be available.

Question 8

Fringe benefits tax applies to the provision of a range of specific benefits, the most common of which are motor vehicles, low-interest loans and housing. It also covers general benefits such as expense payment and residual benefits.

Employers who provide the benefits are liable for the tax. The employee recipient is not taxed on the benefit. However, in practice the cost is effectively shifted to the employees are so while the employees have no legal liability they effectively where the tax through their package. Often recommended that the FBT should be replaced by a tax on the employee.

The FBT year runs from 1 April to 31 March with fringe benefits tax being payable in quarterly instalments. Payment is usually required by 21 July, 21 October, 21 January and 21 April. Quarterly payments are generally not required when the previous year's tax was less than $3000. The rate of tax is usually the maximum marginal rate of tax for resident individuals plus the Medicare levy. Currently that gives rise to a comprehensive rate of 49%.

FBT is deductible for income tax purposes but because of the gross up method for calculating the total amount subject to FBT there is no overall saving.

The relevant legislation contains a general anti-avoidance provisions in section 67 which allows the Commissioner to cancel a tax benefit if it would be concluded that an arrangement was entered into a carried out for the sole dominant purpose of the employer obtaining the tax benefit. The concepts are similar to those in Part IVA.

Schemes have been created where fringe benefits have not been granted in respect of employment and by manipulating the valuation rules to bring down the level of FBT payable. Whether such measures fall within section 67 will very much depend on the circumstances.