

## THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2017

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### PAPER 2.01 – AUSTRALIA OPTION

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#### ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

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TIME ALLOWED – 3¼ HOURS

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This paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **One** question from **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

#### Further instructions

- All workings should be made to the nearest month and in Australian Dollars, unless otherwise stated.
- Start each answer on a new page and clearly indicate which question you are answering. If you are using the on-screen method to complete your exam, you must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.
- Marks may be allocated for presentation.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering Parts B and C.
- The first 15 minutes of the exam consists of reading time. You will be allowed to annotate the question paper during this time; however, you will **not** be permitted to start writing or typing your answer, or use a calculator. The Presiding Officer will inform you when you can start answering the questions.

## PART A

**You are required to answer BOTH questions from this Part.**

1. Under Australian law, Blue Octopus Pty Ltd (Blue Octopus) is an Australian resident company. It has derived the following forms of income from its foreign operations:
  - A dividend of \$30,000 from its wholly owned subsidiary in the Cook Islands. This income was derived by the Cook Islands subsidiary from a substantial term deposit, held for two years with a bank in the Cook Islands;
  - A dividend from its wholly owned United States subsidiary, which was derived from a business activity carried on in the US;
  - Interest income received from a term deposit which it had in a bank in Shanghai;
  - A capital gain from the sale of shares in a company based in Vanuatu. The Vanuatu subsidiary carried on a tourist business in Vanuatu; and
  - A royalty which it receives for certain intellectual property rights, associated with a trademark owned and maintained in Ireland.

**For each of these items, the directors of Blue Octopus require your advice regarding how the amounts received will be taxed in Australia, if at all, and whether there are any offsetting deductions or credits which might apply.**

**If, in any given case, you require further information in order to make a reasoned response, please provide details of the additional information required. (25)**

2. Under both Singapore and Australian law, Resonate, Inc. (Resonate) is a Singapore incorporated and tax resident company with the following interests in Australia:
  - A property holding in Perth, which consists of an eight storey building in the central business district from which Resonate derives substantial rent;
  - Shares in a multinational mining company, listed on the Australian Stock Exchange, from which Resonate receives fully franked dividends;
  - Shares in a speculative mining company from which Resonate receives wholly unfranked dividends;
  - Business income from its activities in promoting and selling products in Australia. An unrelated distribution company is responsible for distributing the goods produced by Resonate in Australia. Orders for the goods are placed in Australia with the distributor, but the actual contracts are formed by direct correspondence between the end user and the Resonate office in Singapore; and
  - Interest income paid by an Australian bank on a term deposit held by Resonate at the bank's Melbourne branch.

**Resonate's board of directors has sought your advice regarding the correct treatment of income flowing to Resonate from the items above. Your answer should address the impact of any relevant double taxation agreement (DTA), and explain how, if at all, the DTA affects the application of Australian domestic law.**

**In addition, the board of directors is considering liquidating all of Resonate's Australian holdings and requires your advice regarding the tax treatment of the above amounts in the event of the holdings' liquidation. (25)**

## PART B

**You are required to answer ONE question from this Part.**

3. Michelle Rubicon is a 45-year-old who works as a computer programmer for IT Specialists Pty Ltd (IT Specs).

In the 2015 calendar year, Michelle received a salary of \$125,000 together with the following additional benefits provided by IT Specs:

- A company car, which Michelle is free to use as she pleases. The car was purchased as a new vehicle by IT Specs on 1 December 2015 for \$56,000;
- Payment of Michelle's monthly telephone bill;
- A \$200,000 loan made to Michelle by IT Specs, at zero interest for three years. The loan funds were advanced on 1 January 2015;
- Payment of Michelle's subscription to a professional computer magazine; and
- Payment of 5% of Michelle's base salary to the IT Specs Super Fund.

**Are any of these amounts taxable in Australia? If so, answer in broad terms how the tax will be calculated and by whom the tax should be paid.** (20)

4. The Second Hand Goods Company Pty Ltd (SHGC) is a company run by Fred Trenello, which is in the business of purchasing and reselling a range of second hand goods. It commenced business upon incorporation on 1 November 2012, and its main shareholder and manager is Fred. Fred regularly visits second hand goods shops to look for bargains.

While visiting a second hand goods shop, Fred recently found an antique table on sale for \$5,000 plus goods and services tax (GST). He thought this is a cheap price, but was unsure. In any event, Fred liked the design and decided to purchase the table on the spot in his own name. Fred is not personally registered for GST and, accordingly, paid \$5,500 including GST for the table but with no entitlement to an input tax credit.

Two weeks later, Fred had the table formally valued by a third party expert at arm's length, who assigned it a market value of somewhere between \$20,000 and \$28,000, exclusive of any possible GST.

Two months later, Fred sold the table to SHGC for the best estimate of current market value of \$22,000. SHGC then displayed the table in its showroom and eventually sold it as a second hand good for \$28,000 plus GST, claiming an input tax credit of \$2,000 at the time of sale.

**You are required first to identify the GST consequences of the transactions described above, in the absence of Division 165 of the GST Act.**

**You should then consider whether Division 165 may be applicable to this case. If Division 165 does apply, what penalties and adjustments will be applicable?** (20)

## PART C

**You are required to answer TWO questions from this Part.**

5. Linda Germaine is a 43-year-old Australian resident who owns two properties in Australia:

- A house in rural New South Wales which was purchased by way of exchange of contracts in June 1985; and
- An apartment in Sydney's central business district, which Linda purchased by way of exchange of contracts in June 1999.

Linda paid a total of \$600,000 for the house and \$900,000 for the apartment. She undertook some improvements on both properties in 2003, incurring expenses of \$25,000 on the house and \$300,000 on the apartment.

Linda borrowed heavily to finance both the acquisitions and the 2003 improvements, and paid substantial interest to her Australian bank during each year of her ownership.

Linda has now received the following offers for both properties:

- \$2.1million for the house; and
- \$3.6million for the apartment.

In considering the offers, Linda has sought your advice regarding the tax for she will be liable if she accepts both offers at the current levels.

Linda notifies you that she has never claimed for any of the expenses incurred in relation to the improvement works performed on the properties. She did, however, claim her interest expenses against her annual income.

**You are required to provide Linda with a full explanation of any taxes for which she will be liable, how the taxes will be calculated, and the timing of the tax payments.**

**Linda is not a lawyer, and has asked for your advice to be as straightforward and easy to understand as possible, avoiding technical language where possible. (15)**

6. The finance minister of a recently elected African government is seeking to understand how trusts are taxed around the world, and has requested your advice regarding the Australian position. In particular, he seeks a simple explanation of the taxation treatment of trusts under Australian income tax law with emphasis on the following questions:

- Who gets taxed on trust income, and at what rate?
- What specific problems arise in calculating the taxable income of a trust?
- Are there any special rules for dealing with capital gains?
- Are there any special rules for dealing with minors?
- How are trust losses dealt with?
- Are there any anti avoidance rules that specifically target trust arrangements?

**You are required to advise the finance minister, using simple examples to highlight your points. (15)**

7. Re-boot Pty Ltd (Re-boot) is a company that is tax resident in Australia. It was incorporated on 15 May 2010, and its purpose and function is to provide IP and related software solutions to large corporate firms based in and around Adelaide, Australia.

Immediately after incorporation, the company issued one million \$1 shares, which were held equally by its two founding members, Rod and Carol. For the years ending 30 June 2011 through to 30 June 2015, Re-boot reported the following levels of taxable income:

	\$
2011	(60,000)
2012	(200,000)
2013	50,000
2014	250,000
2015	(300,000)

As a result of the losses incurred in the early years, the company required further capital, and on 1 July 2013 issued a further two million \$1 shares to a second company, Gratis Pty Ltd.

As of 1 July 2015, the directors of Re-boot decided to increase the range of services provided by the company, and began offering a service dealing with hardware issues relating to computers for which it provided software services.

On 1 July 2016, the shares in Re-boot were sold in their entirety to a boutique firm for an agreed cash price.

**You are required to explain whether the losses can be carried forward for utilisation against taxable income in each of the relevant years. Your answer should refer to any applicable case law, statutory provision or administrative ruling relevant to your analysis.** (15)

8. **You are required to explain the background, issues and decisions in the following cases relating to Australian income tax law:**

- **FCT v Whitfords Beach Pty Ltd 82 ATC 4031; and**
- **FCT v Myer Emporium Ltd 87 ATC 4363.**

**Would the decisions be any different, if the cases were to be decided today?** (15)