Chartered Institute of Taxation
Excellence in Taxation

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

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ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

Suggested solutions

Question 1

Part 1

This question requires some discussion of whether or not Gromore is an Australian resident company. It is resident in Australia if it is incorporated here; it carries on business and has its central management and control in Australia or it carries on business and has its voting power controlled by Australian residents. Clearly in this case it would be treated as an Australian resident on the basis of its Australian incorporation.

The dividend receives from the US subsidiary is not assessable income and not exempt income based on the strength of section 768 – 5(1) ITAA 1997 (previously section23AJ ITAA 1936. Critically this assumes that there has not been no prior attribution of income under the CFC rules.

The dividend income from the 6% shareholding in the manner wire to company is fully assessable to Australian tax but with a foreign tax offset available in respect of any tax withheld that a wire to pursuant to Division 770 ITAA 1997. Again this assumes there has been no prior attribution of income under the CFC rules.

The royalty income received from the Thai subsidiary is fully assessable but subject to a foreign income tax offset pursuant to Division 770 ITAA 1997.

The substantial capital gain from the sale of the shares in the Thai subsidiary will be reduced to 0 for capital gains tax purposes in Australia if the active foreign business asset percentage of the Thai company is 100% (Division 768-G ITAA 1997). In other words, if all the assets utilised in the Thai company are used in the conduct of an active business gains tax will be payable in Australia. This will also be the case if no less than 90% of the assets are so used. Where a lesser percentage than 90% is used in the conduct of the business the capital gain will be reduced to the extent of that percentage.

The interest income in the Hong Kong company would be treated as passive income and the Hong Kong company itself would be a controlled foreign company for the purposes of Part X ITAA1936. All the income from the construction businesses in Hong Kong Vietnam's Singapore should be treated as active income. Accordingly in rough terms if the interest income is no more than 5% of the total turnover of the Hong Kong company there should be no attribution of income under the CFC rules. If the percentage is greater than 5% in the interest income would be attributed and treated as the assessable income of Gromore in the year to 30 June 2014. Any subsequent dividend that might be paid by the Hong Kong company out of its previously attributed profits would be non-assessable, non-exempt income under section 23AI ITAA1936.

Part 2

The dividend paid to the Australian resident individual holding 30% will be fully assessable but with franking credits for any tax paid in Australia. To the extent that the dividend is paid out of the US company profits there will be no franking credits since the dividend would not have been taxed in the hands of the Australian company. Equally if the substantial capital gain was not taxed to the company because of division 768 – G there would be no franking credits available to the Australian resident individual.

The dividend paid to the Australian resident company holding 30% will again be assessable to the Australian resident company but with franking credits for any tax paid in Australia. Division 770 especially section 770 – 135 may have a part to play here as well.

An unfranked dividend paid to the US resident company holding 20% would be subject to a 5% rate of withholding tax in Australia as a result of the Australia/US double taxation agreement – article 10(2)(a).

A franked dividend or the US resident company holding 20% would not be subject to withholding tax as the dividend is fully franked: s 128B(2)(ga).

An unfranked dividend paid to the Vietnamese resident individual holding 20% would be subject to a 30% withholding tax in Australia to the extent the dividend is unfranked unless it is conduit foreign income under division 802 ITAA 1936.

A franked dividend paid to the Vietnamese resident individual holding 20% would not be subject to withholding tax as the dividend is fully franked : s 128B(2)(ga).

Question 2

There would need to be some discussion of the residency of Bears which would seem to be a dual resident company under the Australia/Thai double tax agreement. Students would need to check that agreement to see whether there is any tie-breaker provision and if there is seek to apply it to give some logical basis for determining whether the tie-breaker applies such as to give residency to either Thailand or Australia for the purposes of the application of the double taxation agreement. As it happens there is such a provision in the Thai agreement namely article 4(5) and it provides that where there is dual residency the company shall be deemed to be a resident only of the contracting state in which it is incorporated created or organised. The facts give us no information in this regard.

Mini-Bears is a Thai resident and clearly not an Australian resident.

Assuming that Bears is an Australian resident company the interest and royalty payments would be made by an Australian resident company to a Thai resident company. The dividend however would flow from the Thai resident to the Australian resident company and then on to the various shareholders inthe Australian parent company.

As far as the interest is concerned this would be subject to a 10% withholding tax in Australia which would be unaffected by the Australia/Thai double tax agreement as that agreement while specifying a maximum rate of 25% does not affect the rate to be imposed by Australia. It is simply a ceiling and as the Australian domestic law seeks to impose only a 10% rate that is the applicable rate. (See article 11(2)).

As far as the royalty is concerned that would ordinarily be subject to a 30% rate of withholding tax coming out of Australia but that rate is restricted to 15% by virtue of article 12(2).

As far as the dividend flowing from Thailand to Australia is concerned that dividend would be restricted to withholding tax in Thailand of 15% on the basis that the company paying the dividends (ie Bears Mini) is an industrial undertaking – see article 10(2)(a).

As far as the fee that Bears pays to its Thai subsidiary is concerned the question arises as to whether the receipt of this money by the Thai subsidiary gives rise to a tax liability in Australia. One way in which this may arise is if the Thai subsidiary where to have a permanent establishment in Australia and the facts suggest that this is a possibility having regard to the fact that the Thai subsidiary employs a team of people who fly to Australia for the purpose of organising sales in Australia and are present here for anywhere up to 9 months. It is significant that all sales are referred back to Bears Are Us but this may not be enough to eliminate the possibility of a permanent establishment. Some reasonably detailed discussion of article 5 Australia/Thai double tax agreement would be the expected.

Question 3

As RDS would appear to be a resident on all bases in Volantis and not in Australia and as all income is sourced outside Australia, there would appear to be no basis for taxing the income derived by RDS on a direct income tax basis from Australia. Rather the only genuine possibility would appear to be the controlled foreign company rules contained in Part X of the Income Tax Assessment act 1936.

This raises the question whether RDS would be treated as a CFC. In order for this to be the case there must first be a company as that term is understood in Australian law - as it would seem to have perpetual existence and a separate legal identity, the prospects are good for treating it as a company under Australian law

A further question arises as to whether there are any shares or shareholding interests in RDS and this would only appear to be the case if the approved membership rights could be treated as such. Students would be expected to do some details analysis of the relevant provisions to establish whether the approved membership rights constitute shares or share like interests in RDS.

Assuming that RDS is treated as a company and the approved membership rights give rise to shareholding interests, the next question would be to consider the nature of each item on income that has been derived by RDS to determine whether they amount to tainted income which would be taxed in Australia in the year ended 30 June 2014.

The interest income from the bank deposit would clearly be tainted interest income under the definition of that turn section 317 (1).

The royalty income would be tainted royalty income unless the royalties were derived course of the business carried on by RDS and at the time the royalties were derived by RDS the entity liable to pay the royalties is not an associate of RDS. Clearly this is not the case here and accordingly the amount in question would be tainted royalty income.

The business income from the running of the hotel by RDS would not be tainted income.

The capital gain from the sale of the hotel would only be passive income if it fell within section 446(1) (k) being a net gain that accrued to RDS in respect of the disposal of tainted assets. As the definition of tainted assets excludes an asset used solely in carrying on a business and the hotel was so used in solely in carrying on a business, the capital gain would not be a gain derived from the sale of the tainted asset and accordingly the amount in question would not be passive income.

Somewhat simplistically it would appear that the total revenue of RDS is $890,000 of which $90,000 is tainted income. This would mean that RDS fails the active income test with the consequence that the $90,000 being the 50,000 interest income and $40,000 royalty income would be subject to tax in Australia for the year ended 30 June 2014 under section 456 of the relevant act.

However, this is all premised on the basis that the approved membership rights give rise to a direct attribution interest as defined in section 356 and looking at the nature of the rights that would appear to be likely. If that is the case of the CFC rules would have no application.

Question 4

Part1

While it may be the case that Part IVA was only meant to apply to blatant, artificial or contrived schemes, we Have seen that in practice it has had a broader operation and can apply to quite commercial arrangements. However depending on one's perspective it might be argued that even these commercial arrangements are in some fashion at least contrived or artificial arrangements. Cases in point that students should refer to and discuss include Spotless Services, BAT Industries, News Corp, Futuris and Hart.

Part 2

The thin capitalisation rules are now contained in division 820 and occupy over 100 pages of complex often unintelligible legislation. They require an analysis of different categories of tax payers and require the application of the rules depending on which categories the taxpayer falls into. There are complex mathematical method statements involved and value judgements in respect of the value of assets liabilities and equity. There are also odd references to arm's-length debt tests which have regard to aspects as vague as the current state of economic conditions in Australia. To assert that the rules are overly complex and burdensome is arguably an understatement although some attempt to address this problem has been made by increasing the demeanour must test at which the thin capitalisation rules will apply. This has solved the problem part but for companies that are caught within the web of the thin capitalisation rules they are without any doubt some of the most complex and burdensome rules that exist in the current Australian legislative framework there is a need to find a more straightforward method for controlling this problem and the authorities are currently looking at this.

Part 3

The individual residency rules are not nearly as black and white as those which apply for example in the United States and they call into question issues such as the domicile, permanent place of abode and usual place of abode of an individual taxpayer. At one level they require a full detailed analysis of the entire facts and circumstances of a tax payers existence so as to determine whether the taxpayer would be treated as an Australian resident or not. This has led to a large number of recent cases dealing with the question of residency – see for example Mynott Clemens Jaszenko and Beizendorf. However, relatively speaking there are not that many cases involving complex individual residency issues and it would seem to be somewhat of an overstatement suggest that there is an urgent need for simplification. There are arguments to suggest that a more straightforward black and white test may be appropriate but this is by no means a fixed and clear view that applies generally across the Australian landscape. For the most part the rules do not give rise to problems but uncertainty can arise in marginal cases.

Question 5

Part 1

Is there has been provision by a person at a particular time of property to another person, the provision of the property is taken to constitute a benefit being a property fringe benefit under section 40.

It is clearly an external property fringe benefit and would be given a taxable value pursuant to section 43 of the cost price of the recipients (i.e. Sarah"s) property to the provider (ie her employer). This gives rise to a taxable value of $3,500 but this must be reduced by the extent of Sarah's contribution namely $1,200. Accordingly the taxable value included is $2,300.

Part 2

Provides that alone fringe benefit arises from a loan to an employee on which a low rate of interest is charged or on which no interest is charged.

There was for some time some confusion as to whether this might also apply in respect of a reduction or waiver of a loan establishment fee. The decision in Westpac Banking Corporation the Federal Commissioner of taxation (1996) 34 A TR143 conclusively resolved that the waiving of a loan establishment fee for employees was a separate residual fringe benefit and not part of the same loan fringe benefit that the low interest loan generated. Accordingly the benefit to John would be treated as a residual fringe benefit and the taxable value would be the full amount of $2,500.

Part 3

Since Elouise has been granted a right to occupy or use a unit of accommodation as her usual place of residence this would amount to a housing benefit for the purposes of section 25. The situation seems to meet all the requirements for a fringe benefit and accordingly would be subject to fringe benefits tax pursuant to the housing fringe benefit provisions.

The accommodation is in Australia and does not seem to be in a remote area. Further, the accommodation is not a hotel, motel, hostel, guesthouse, caravan or mobile home.

Accordingly, the taxable value would be calculated as the statutory annual value of the right to occupy the accommodation unless any rent paid by the employee. Ordinarily this would amount to the market value of the right to occupy the accommodation for the year in question.

The Thus, the appropriate amount to include as taxable value would be $46,000 being the market rent less the contribution made by Eloise.

Part 4

Ordinarily this would be a fringe benefit but under division 13 there are a number of miscellaneous exempt benefits including under section 58 P minor benefits which are infrequent and irregular and less than $300 for the current year in respect of the employee.

Thus provided this is not a regular benefit that is being provided to that on an ongoing basis the full extent of the benefit would be exempt.

Part 5

Ordinarily reimbursement of such an expense would give rise to an expense payment fringe benefit under section 20.

However, as a result of the otherwise deductible rule embedded in section 24, the taxable value of the fringe benefit in question would be reduced by the amount equal to what would have been allowable as a once-only deduction to Guy in respect of the payment which he made for the self-education expenses. This clearly would only apply if the payment for the self-education expenses by Guy would itself be deductible by reference to other provisions of the Income Tax Assessment Acts of 1936 and 1997.

Thus, if the amount in question is clearly connected with his on-going position within the company and is not for example for the purpose of enabling him to secure a different position within the company, the amount in question would ordinarily be deductible. Accordingly, the full amount should operate to reduce the taxable value such that there is no amount subject to FBT.

Question 6

Part 1

At the domestic level capital gains derived by residents running ownership foreign assets is essentially governed by the normal capital gains tax rules and as to the effect that residents pay tax on worldwide capital gains. This certainly would apply as a general proposition however, because of the application of division 768 – G ITAA 199 there is one very large exemption for Australian companies owning foreign assets being shares in a foreign company where the underlying assets of the foreign company are active business assets.

To the extent that that is the case, capital gains will be reduced to reflect the percentage of active business assets. If the active business assets exceed 90% of the total assets of the company the whole of the capital gain will be disregarded if the active assets of the company are less than 10% of the overall value of the assets of the company none of the capital gain will be disregarded. In between 10% and 90% it is that percentage of the capital gain which will be disregarded. Thus if 40% of the assets are used in the conduct of an active business 40% of the capital gain on sale of shares be disregarded.

Furthermore, where a double tax agreement is involved in Australia is right to tax any capital gain will be regulated by the double tax agreement. If the double tax agreement limits Australia is right to tax or excluded entirely then the double tax agreement will override the operation of the domestic law. Thus, if domestic law allows Australia to tax a capital gain derived by an Australian resident in respect of the foreign asset but the treaty excludes that right then the exclusion imposed by the treaty will apply. The relevant article to considering most cancers instances is article 13 dealing with alienation of property but in some instances the critical article may well be the business profits article (usually article 7) see in particular feel Thiel v FCT.

Part 2

Whether the reverse situation applies and a foreigner owns assets in Australia, the foreigner will only be subject to tax under Australian domestic law in Australia if the asset involved is taxable Australian rural property, and interest in such property, and an asset used in a permanent establishment in the conduct of a business in Australia. Apart from these limited circumstances Australian capital gains tax would not apply. Students should have an aid that taxable Australian rural property will also include more than 10% of the shares in a company or units any unit trust be if an Australian or foreign company or unit trust where the underlying assets of the company are themselves taxable Australian rural property. Thus a foreigner who owns shares in another foreign company and disposes of those shares will be subject to Australia in respect of the disposal of foreign shares if the foreign company has mainly Australian real property interests. This essentially means 50% or more of the assets by value of the company are Australian taxable real property.

Even if that is the case, and Australia can tax under our domestic law a double tax agreement may operate to preclude Australia is right to tax in certain cases. This requires a careful analysis of the relevant double taxation agreement but usually this will only apply where the business profits article is the operative provision and it circumvents Australia is right to tax because the foreigner does not have a permanent establishment in Australia and accordingly article 7 precludes Australia is right to tax the business profit. The classic example of this but not specifically in the context of a capital gain was Thiel's case to which students should refer. Some detailed discussion of double tax agreements would be warranted.

Question 7

The requirements for the existence of a taxable supply are specified in section 9 – 5 and are as follows:

- The person making the supply must be registered or required to be registered;
- The person making the supplier must do so in the course or furtherance of an enterprise that he/she your it carries on;
- The person making the supply must make it for consideration;
- The supply must be connected with Australia; and
- The supply must not be GST free or input taxed.

The requirements for the existence of a creditable acquisition are specified in section 11 – 5 and are as follows:

- The person making the acquisition must make the acquisition solely or partly for a creditable purpose;
- The supply of the thing to the person making the acquisition must have been a taxable supply;
- The person making the acquisition must provide all must be liable to provide the consideration for the acquisition; and
- The person making the acquisition must be registered or required to be registered.

The concept of the supply can give rise to a number of problems that have been highlighted in a number of recent Australian cases including Qantas Airways, reliance holdings and the AP Group.

Problems can also arise in defining the concept of an enterprise – se Re Private Tutor and FCT (2013) AATA 136 and Re Bayconnection Property Developments Pty Ltd v FCT (2013) AATA 40.

These two concepts of taxable supply and creditable acquisition are critical to the operation of the GST. In particular GST is payable by a person who is registered for GST or required to be registered for GST on taxable supplies which are made in the relevant tax periods less any input tax credits that arise in respect of creditable acquisitions and creditable importations. Thus, leading to one side creditable importations it is the difference between the GST on taxable supplies input tax credits on creditable acquisitions that gives rise to the net liability to GST for a given tax period. Consequently the identification of taxable supplies and creditable acquisitions is critical.