

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2026

MODULE 2.01 – AUSTRALIA OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Candidates would be expected to discuss the statutory provisions, case law and rulings applied to the factual circumstances determining individual and company residency. This would include discussion of the early cases on residency such as Applegate and Jenkins and interpretation of the terms “domicile” and “usual place of residence” under the first two of the three tests in the ITAA 1936 section 6 definition of a resident. More recently, the ATO has issued Taxation Ruling TR2023/1 Income Tax: residency tests for individuals which outlines scenarios, and the case of *Quy v FCT* [2025] ARTA 174 is topical.

Part 1

This part concerns the implications of individual and company residency status for income tax purposes. The significance of this distinction is that residents are taxed on their worldwide ordinary income while foreign residents are only taxed on their Australian source ordinary income or income included under a provision on some other basis than being Australian source.

Alice: was most likely still a resident of Australia initially after she left Australia for the US but at some point fell into the definition of non-resident under the first and/or second of the section 6 tests. In the period 8 to 7 years ago Alice was likely a resident of Australia, despite living in the US, as her move there appears to be temporary depending on her success as a movie star. It is likely that Alice ceased to be a resident of Australia 6 to 5 years ago, when her US movie career took off. In the period of 4 to 3 years ago Alice reduced her Australian connections to a minimal level, indicating likely ongoing non-residency. In the last two years Alice spent over half the year outside Australia and did not have a domicile there, indicating non-residency.

Hugh: Is most likely a resident of Australia for the current year and all past years per the third test in the section 6 definition of “resident” under subsection (iii) (A) which includes a member of a superannuation scheme for persons employed by the Commonwealth. This test will continue to apply to him even after Hugh moved to the US and cuts all other connections to Australia. Even after leaving Commonwealth employment, he remained a member of the scheme and so was covered by the third test until he reached his preservation age and ceased to be a member. Once his membership ceased four years ago, he needed to be evaluated under the other two tests, and it appears he was then likely a non-resident under either of these tests.

AusArtists Pty Ltd: is a resident of Australia for most of the past years per the section 6 definition of “resident” in the ITAA 1936 under subsection (b) includes “(b) a company which is incorporated in Australia ... and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia.” The central management and control (CM&C) test will change in that CM & C moves to the USA, and its directors (Alice and Hugh) becoming non-residents at different points in time, exercising control of the company from the US. The company therefore likely became a non-resident four years ago.

Part 2

Income from property sourced in Australia and capital gains from the disposal of Australian property, a form of statutory income, are both taxable in Australia when derived by non-residents (s6-5 and ss6-10(5) ITAA 1997). Div 104 of ITAA 1997 CGT event A1 makes the disposal of the property a CGT event subject to tax per sec 104-10(1)-(4).

Alice owns a 50% interest in the Sydney property (a taxable Australian asset) and will nominally be subject to CGT on 50% of the gain, with Hugh taxed on the other 50%. However, they may be able to claim that the property was their principal place of residence and so subject to CGT exemption under the 6-year absence rule in sec 118-145(2).

The property would otherwise be subject to the residence exemption subject to:

- the gain being apportioned over the periods it was either a residence or a rental property. Over the 25 years of ownership, it was leased out for 6 years (sec 118-190); and
- a reduction in the exemption for the 10% of the floor space used for business purposes as the office of AusArtists Pty Ltd for 4 years before becoming a rental property.

After Alice became a non-resident, she would be taxable on an Australia capital gain as the property is a ‘taxable Australian asset’ and the exemption in Div 855 would not apply. Alice and Hugh cannot access the exemption if they are excluded foreign residents within the meaning of ss118-110(4) ITAA 1997, which applies to a person who has been outside the country for more than 6 years.

If an excluded foreign resident, Alice's taxable Australian property would be subject to a capital gain of \$2,000,000; being the \$3,000,000 sale price less the \$1,000,000 cost base, divided by the two owners to \$1,000,000 each, less the 50% CGT discount to a \$500,000 gain for Alice. The 50% discount in sec 115-100 is adjusted for non-residents by sec 115-105(1)-(2) to deny the discount to the extent that they accrued a capital gain while a foreign resident. The discount will only be available to Alice and Hugh pro-rated from the period 8 May 2012 to the dates they became non-residents.

The sale may also be subject to the foreign resident capital gains withholding tax of 15% with no threshold.

Part 3

Candidates are expected to broadly cover the Personal Services Income (PSI) rules which are contained in Part 2-42 of the ITAA 1997. These provisions act as a type of specific anti-avoidance rules ensuring that professionals who enter into contracts of service with related entities cannot reduce, alienate, or split their income through their interposed trusts, companies, or partnerships. Per sec 85-4(1) the Part applies if the income is mainly a reward for personal efforts or skills. The effect of application of the PSI rules is to limit deductions for specified expenses such as rent, mortgage interest, rates and land tax. Div 86 covering alienation of income does not apply as AusArtists Pty Ltd is conducting a personal services business. Alice entering into a 5-year contract with a single movie studio may trigger the point at which the PSI rules apply.

Question 2

Part 1

Income issues: the question involves the Capital Gains Tax (Div 104 of the ITAA 1997) issues of the company. The sale of an asset is a CGT event A1. The company made a capital loss on the sale of the Vanuatu property and capital gains/losses on the sale of shares, some in Australia and some overseas. In working out the net capital gains subject to tax in Australia, only the losses from the sale of Australian property and shares can be considered. The losses on sale of the overseas property and overseas shares cannot be deducted from any gains in Australia. The company will include in its income the net capital gain (gains minus losses) and if this is a negative figure the net loss will be quarantined from other income types and carried forward against any future capital gains.

The income issues also involve foreign income tax offsets available under Div 770 of the ITAA 1997. The dividends from overseas sources have suffered withholding tax of nil, 10% or 15%. Where withholding tax has been deducted the company can seek an offset for this, as evidenced by the documents from the overseas tax authority. The company can only obtain a credit up to the amount of Australian tax payable on the dividend, and the difference will be borne by the company, with no carry forward of excess credits. Under the Income Tax Rates Act 1986 the company's tax rate is 30% (not the base rate of 25%) as its turnover is less than \$50M and more than 80% of its income is base rate entity passive income (per secs 23AA-AB). The tax payable in Australia will be 30% where the dividends have not been taxed; 20% where the withholding rate was 10%; and 15% where the withholding rate was 15%.

Part 2

A fringe benefit under the FBT provisions in sec 18 of the FBTA 1986 would usually apply to Bill as a director under the extended definition of employee in sec 6(1) ITAA366. The taxable value of a loan fringe benefit is the difference between the interest calculated on a daily balance at the benchmark rate (exceeding 8% for the last 3 years) and the actual interest accrued of 5%. However, Division 7A applies in preference to FBT to loans made by a private company to a shareholder or their associate per sec 109ZB(1)-(2) ITAA36. This is the case even if the loan is made to the shareholder or their associate in their capacity as an employee or an associate of an employee. The loan is not a complying one for Div 7A purposes as the interest rate is below the benchmark rate, has a term over 7 years for an unsecured loan and is not documented.

Samantha as a director of the company is an employee under the extended definition of that term, and so any benefit provided falls under the FBTA 1986. The provision of the leased motor vehicle is a fringe benefit to the extent that it is used privately but does have the records to substantiate this, so would be fully taxable. In the second half of the tax year the vehicle was provided to Samantha's son for 100% private purposes. A fringe benefit includes a benefit provided to an associate of the employee, which the son is. Per sec 318(1) of the ITAA 1936 an associate of a natural person includes a relative of the primary entity, and this definition is linked to the definition of associate in the FBTA.

The vehicle would have a taxable value of $12 \times \$1,000 = \$12,000$. The tax payable would be 47% of the uplifted value of \$24,960 ($\$12,000 \times 2.08$) which is \$11,731. The uplift factor is obtained by dividing 100 by 47.

The company would obtain an income tax deduction for both the GST-inclusive cost of providing the car (assuming the company is not registered for GST) and the FBT paid on the benefit.

Part 3

Legal expenses will be deductible if they are incidental or relevant to the production of the business operations and not private or capital per s8-1 of the ITAA 1997. Case law indicates that the expenses must have a close connection to income producing activities (Magna Alloys and Research Pty Ltd v. FC of T 80 ATC 4542) and if the nature of the advantage sought is an enduring benefit, then the expense is of a capital nature (Hallstroms Pty Ltd v. FCT (1946) 72 CLR 634). The distinction must be made between expenditure incurred for the purpose of preserving and protecting business assets and expenditure which the business may require as part of prudent management in order to be deductible. The company's legal fees in relation to the proposed new structure relate to a question of capital (how the share capital of the new company and trust formation will move assets away from the existing company) and not a revenue issue. Despite the purported reason for the restructure being to improve the revenue streams, this will only be achieved through a restructure of a capital nature, which would usually not be deductible as being of a capital nature.

PART B

Question 3

The candidate is required to demonstrate knowledge of the provisions of the Taxation (Multinational — Global and Domestic Minimum Tax) Act 2024 as applied to the facts in the question, and the Treasury Laws Amendment (Multinational G/oba/ and Domestic Minimum Tax) (Consequential) Act 2024 changes to Schedule 1 to the Taxation Administration Act 1953 (TAA).

Part 1

All the companies will be considered group members, and Big Pty Ltd is a Constituent Entity (CE) in the Australian jurisdiction. Under the Act the four types of entities listed are treated per specific provisions of the Taxation (Multinational — Global and Domestic Minimum Tax) Act 2024 as follows:

<u>Entity</u>	<u>Section</u>	<u>Treatment</u>
Pension fund	20(1)(d), 23(1)	Is an Excluded Entity and so not subject to the GloBE rules.
Charitable foundation	22(2)	Treated as a non-profit organisation and so not subject to the GloBE rules.
Joint venture	26(1)(b)	Not a joint venture for GloBE purposes as less than 50% ownership.
Permanent establishment	38(1), 39(1)	The PE is 20% owned by the UPE, 20% by Big Pty Ltd and 20% by a Big Group wholly owned subsidiary incorporated in Jurisdiction X, so the ownership interest percentage is summed to 60%, so subject to the GloBE rules as greater than 50%.

Excluded Entities are not CEs of the group, and while per Rule 1.6 an Excluded Entity is not subject to the GloBE Rules, the revenue of an Excluded Entity is included in ascertaining whether the €750 million GloBE Threshold has been satisfied.

The definition of an Applicable MNE Group under section 12(1) of the includes: for at least 2 of the 4 Fiscal Years immediately preceding the test year, the MNE Group's annual revenue is equal to or greater than its GloBE Threshold for the Fiscal Year.

In two of the years the turnover was under the threshold. In one of the test years Big Group had a turnover of €800 million equivalent, exceeding the €750 million threshold.

In the earliest year Big Group had a turnover of €400 million equivalent for 6 months. Using the formula in section 12(3)(b): $6/12 \times 750 \text{ million} = €375 \text{ million}$ reduce threshold. As turnover in this period was €400 million equivalent, the threshold is exceeded in both Year 1 and Year 4, so Big Group is an Applicable MNE Group for the purposes of the Act as it meets the 2 out of 4 prior years for the current test year

Part 2

The Group files consolidated accounts in the other country with which Australia has a Qualifying Competent Authority Agreement (QCAA), so the UPE in that other jurisdiction has the primary obligation to file the GIR. The ATO has access to the GIR through the competent authority process. However, if the UPE fails to file the return in the other jurisdiction the ATO can require Big Pty Ltd to file the GIR in Australia.

Apart from any secondary requirement to lodge the GIR, Big Pty Ltd will be required to file the following with the ATO:

- a Foreign Notification Form (FNF) which notifies the Commissioner that a foreign entity has lodged the GIR on behalf of Australian Group Entities and the jurisdiction in which this lodgement was made;
- an Australian IIR/UTPR tax return (AIUTR), an Australian-specific tax return that forms the basis of the ATO's assessment of Australian IIR tax and Australian UTPR tax; and
- an Australian DMT tax return (DMTR), an Australian-specific tax return that forms the basis of the ATO's assessment of Australian DMT tax.

For ease of lodgement, the ATO has combined all three into the Combined Global and Domestic Minimum Tax Return (CGDMTR).

Part 3

The concessions available during the transitional period are set out in draft Practical Compliance Guidelines PCG 2025/D3 titled Global and domestic minimum tax lodgment obligations - transitional approach dated 16 July 2025. They include nil penalties while the MNE gears up for the Pillar Two law, such as upgrading computer systems, so long as the MNE shows they are acting in good faith and have kept proper records. The due date for filing the new returns cannot be extended under the agreed approach between the Pillar Two signatory countries.

Question 4

Candidates are expected to discuss the general rules for taxation of trusts in Part III Div 6 of the ITAA 1936 as impacted by the Subdivision 115-C and 207-B of the ITAA 1997 so as to avoid double taxation of franked dividends and capital gains.

Part 1

The net income of a trust is defined per sec 95(1) of the ITAA 1936 as the total assessable income of the trust estate calculated under the Act as if the trustee were a taxpayer in respect of that income and were a resident, less all allowable deductions. The trust's net income will include the \$8 million net trading income, but Subdivision 6E of the ITAA 1936 will exclude the franked dividends and capital gain under Subdivision 115-C and 207-B of the ITAA 1997 respectively.

Subdivision 115-C has the effect that an amount corresponding to each of those capital gains is taxed in the hands of the beneficiaries of the trust (as a capital gain) and, if necessary, assessed to the trustee. Subdivision 207-B has the effect that an amount corresponding to each of those franked distributions is taxed in the hands of the beneficiaries of the trust and, if necessary, the trustee. It also has the effect that the entity in whose hands those distributions are taxed can take advantage of the relevant amount of related franking credits.

The trust's distributable income will be higher than its net income as the capital gain (before discount) of \$2 million and the dividends of \$1 million will be added to the \$8 million trading income, totalling \$11 million. The ATO's Draft Taxation Ruling 2012/D1 elaborates on this.

Part 2

Beneficiary A (no legal disability, resident): Per sec 97 ITAA 1936 the \$2 million distribution will be added to their other income and taxed at their marginal tax rate. The \$1 million of the distribution will be grossed up by the franking credits and a credit of \$300,000 allowed in the calculation of net tax payable.

Beneficiary B (no legal disability, resident): Per sec 97 ITAA 1936 the \$2 million distribution would normally be added to their other income and taxed at their marginal tax rate. However, the \$2 million capital gain before discount will be treated as a capital gain in B's hands and the loss he made in his own right of \$1 million will be offset to arrive at a net capital gain of \$1 million. Per sec 115-215(1) of the ITAA 1997 Beneficiary B will only be entitled to a 50% CGT discount of \$500,000 and not the \$1 million discount allowed at the trust level.

Beneficiary C (no legal disability, non-resident): Per sec 98(2A) ITAA 1936 the \$2 million distribution is assessed to the trustee rather than the beneficiary due to the beneficiary's non-resident status, as it would be difficult for the ATO to collect the tax on the distribution from a non-resident.

Beneficiaries D and E (legal disability, resident): Per sec 98(1) ITAA 1936 \$500,000 for each of them is assessed to the trustee rather than the beneficiaries due to legal disability.

Part 3

The trustee will be assessed on income to which no beneficiary is presently entitled under sec 99(2) of \$1 million (\$8 - \$7 million) plus the \$3 million distributed to the minor beneficiaries and non-resident adult, totalling \$4 million. The tax imposed under sec 98(3)(a) in respect of individual beneficiaries will be calculated as if the trustee's income were the income of an individual and not subject to any deduction. Under trust law the trustee will usually be indemnified for the tax liability by the trust.

PART C

Question 5

Candidates are expected to describe in summary the controlled foreign company (CFC) provisions of Part X of the Income Tax Assessment Act 1936, which seeks to tax Australian resident companies on their share of CFC tainted income. The conditions to be met under the CFC legislation are that there must be a controlled foreign company (s340 ITAA 1936), with an attributable taxpayer (s361 ITAA1936) and attributable income (Div 7 ITAA 1936) against which an attributable percentage is applied to determine assessable income.

Per sec 356(1)(a) an entity holds a direct attribution interest in a CFC at a particular time equal to the percentage that the entity holds, or is entitled to acquire, at that time of the total paid-up share capital of the CFC. AustSmart Pty Ltd owns 100% of HavenCo and InvestCo and so has a direct attribution interest of 100% of each. Per sec 358 an entity holds an attribution tracing interest in a CFC at a particular time equal to the direct attribution interest in the CFC that the entity holds at that time. Per sec 361(1) AustSmart meets the definition of an attributable taxpayer as it meets both the para. (a) test of 10% and the para (b) test of 5 or fewer controllers.

Per Sec 432 the active income test applied to HavenCo requiring a tainted income ratio (gross tainted turnover/gross turnover) of less than 0.05, the test is failed as the ratio is 100.00. The definition of tainted income per sec 6(1) includes interest, dividends and rent, which HavenCo received. We are informed that InvestCo does not have any attributable income as it had no tainted income, but the information shows that all of HavenCo's income meets the statutory definition of tainted income. In conclusion, AustSmart as the attributable taxpayer in Australia will be taxed on its attributable income of \$500,000 from HavenCo.

Question 6

Candidates are expected to explain relevant provisions of A New Tax System (Goods and Services Tax) Act 1999, which applies broadly to consumption in Australia. At any particular time, GST is payable when sales exceed \$75,000 turnover as measured during the current month and the previous 11 months (s188-15 GST Act) and as projected for the current month and next 11 months. A supply of goods, where those goods are exported from Australia, is GST-free if the requirements of one of the items in the table in subsection 38-185(1) are met. The table is reproduced in paragraph 6 of GST Ruling 2002/6 which amplifies the conditions for exemption.

In relation to past sales by Mechanix Pty Ltd direct to customers, Item 4A of the table covers exports of new recreational boats. The supply of a boat will be GST-free, but only if: (a) the ship is a new recreational boat on the earliest day (the receipt day) on which one or more of the following occurs: (i) the recipient takes physical possession of the ship; or other conditions which are not relevant to this question as instalment sales are not allowed by Mechanix Pty Ltd. The boats must be for private not commercial use, so the exemption would only cover 50% of sales. Further detail from the relevant paragraphs of GST Ruling 2002/6 (paras. 66A-66D) will attract more marks. As the boats are supplied on full payment the instalment payment provisions do not apply.

In relation to the proposal to set up wholly owned subsidiaries in Thailand and Fiji, Item 2A of the table covers export of goods, particularly supplies to associates without consideration. The supply will be GST-free, but only if the supplier exports them from Australia. Further detail from the relevant paragraphs of GST Ruling 2002/6 being paras. 51A-51B will attract more marks.

Question 7

Candidates are expected to recognise that the question is loosely based on *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 (the Chevron case) but also triggers the thin capitalisation provisions in Div 820 of the ITAA 1997. In the Chevron case a US company funded an Australia subsidiary through borrowing from a Delaware subsidiary at 1% and on-lent at 8% to generate a large deductible interest expense in Australia. The arrangement in the case was held by the Full Court to trigger the transfer pricing provisions in Div 815 of the ITAA 1997 as the interest deduction claimed was a “transfer pricing benefit” which the Commissioner could decrease under a determination. The elements of a transfer pricing benefit outlined in sec 815-15(1) should be applied to the facts in the question to achieve higher marks.

The thin capitalisation rule in sec 820-46(1) disallows all or part of an entity's debt deductions for an income year if, for that year, (a) the entity is a general class investor; and (b) the fixed ratio test applies, or the group ratio test applies, or the third-party debt test applies. The thin capitalisation provisions in Div 820 of the ITAA 1997 limits interest deductibility to 35% of EBITDA. In its first year of operation Digger Pty Ltd is expected to have an EBITDA of \$120 million and an interest expense of \$80 million, giving an interest expense ratio of 80/120 or 66.67%. The rules limit deductibility to 35% or $(35\% \times 120) = \$42$ million. The interest deduction in the first year would therefore be limited for tax deductibility purposes from \$80 million to \$42 million (deduction of \$38 million denied).

Question 8

Part 1

The candidate is expected to recognise that the question involves application of the promoter penalty laws in sec 290-50(1) of Sch 1 to the Taxation Administration Act 1953 and examining whether Mr X has engaged in conduct that resulted in themselves or another entity being a promoter of tax exploitation schemes.

FCT v Bogiatto & Ors [2020] FCA 1139 involved alleged tax exploitation schemes each involving claims under Div 355 of the Income Tax Assessment Act 1997 in respect of purported R&D activities. The Commissioner alleged that it was not reasonably arguable that the scheme benefits resulting from the R&D claims were available at law.

Candidates should apply the facts of the case study and express a view as to whether the three elements of sec 290-50(1) have been met:

1. Is there must be an entity which satisfies the definition of "promoter" in s 290-60(1)? That is, has it marketed the scheme, encouraged its growth or interest in it? Has this been a "substantial role"? Has it received consideration for this?
2. Is there a "scheme" which was a "tax exploitation scheme" within the meaning of s 290-65(1)(a) if the scheme has been implemented. It must be reasonable to conclude that an entity that (alone or with others) entered into or carried out the scheme did so with the sole or dominant purpose of that entity or another entity getting a "scheme benefit" and (b) if the scheme has been implemented, it is not reasonably arguable that the "scheme benefit" is available at law; and
3. Is there a "scheme benefit" as defined in s 284-150(1)(a) or (b)?

We are told that Mr X has marketed the scheme widely, has many clients, intends to claim existing expenses and inflate a deduction for consultancy fees. Based on the facts provided in the question it is likely that all three elements will be met and Mr X will be subject to the promoter penalty regime.

Part 2

Candidates should identify that the General Anti-Avoidance Rules (GAAR) of Part IVA of the Income Tax Assessment Act 1936 cover an R&D tax offset as a tax benefit from 1 July 2021. A tax benefit arising out of an R&D claim occurs where the R&D entity entered into a scheme to access the R&D tax offset, a tax benefit is received in connection with the scheme, and the dominant purpose of the R&D entity entering into the scheme is to either enable it to get the R&D tax offset or get a refundable R&D tax offset. If all three conditions are met Part IVA applies to an arrangement and the tax benefits obtained from the arrangement can be cancelled. ATO guidance indicates that an advisor's claim that existing expenditure qualifies as R&D may be an indicator of a scheme. The suggestion By Mr X of high (unrealistic) contract payments to be paid to Jim may also be indicative of a scheme. The ATO may consider cancelling any tax benefit under sec 177F if that tax benefit arose in relation to a scheme.