THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2019

MODULE 2.01 – AUSTRALIA OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

1. There is no specific exemption for such income. There must be some doubt as to whether the item is of an income nature, particularly since the knowledge supplied is likely to be secret knowledge: - Brent v FCT (1971) 2 ATR 563

2. Winnings in the NSW Jackpot lottery are not seen to be income as they are mere windfall gains. If, however, this was won in the context of a business carried on in the form of buying lottery tickets with some plan or scheme involved (most unlikely) there is a possibility this activity may constitute income from gambling proceeds secured in the form or through the form of a business : see *Brajkovich v FCT (1989) 20 ATR 1570*.

3. As this is an honorarium received by an employee of a public authority and not by the public authority itself, there is no exemption and accordingly this is likely to amount to assessable income (see section 50-25 (item 5.2) ITAA 1997).

4. Age pension amounts are fully assessable, although section 160AAAA ITAA 1936 provides a rebate to reduce the tax otherwise payable. This may result in no tax being payable on the amount in question. This rebate applies in addition to the low-income tax offset. Having regard to the small amount received ($8,000) and the likelihood that there is no other income, it is most likely that even though fully assessable, the amount received will not give rise to any tax payable.

5. Amounts received by way of disability support pension are exempt – section 52-10 (item 6.2) ITAA 1997.

6. The benefit provided to the employee in this case is a fringe benefit as defined in section 136 (1) of FBTA. Fringe benefits do not give rise to assessable income in the employees' hands: section 23L.

7. Section 50-15 ITAA 1997 creates the outcome that the union in receipt of this capital gain is exempt from tax on its total ordinary and statutory income (section 102-5 (1) ITAA 1997).

8. Section 51-30 (Item 5.1) ITAA 1997 ensures that maintenance payments are exempt, subject only to section 51-50, which would appear to have no application here.

Question 2

As a result of sections 26-45 (1) and section 32-5 ITAA 1997, subscriptions paid by a self-employed taxpayer to a club are not deductible.

1. As a result of section 26-5, fines paid are not deductible.

2. Expenditure of this kind is of a capital nature and is consequently not deductible as a result of the broad definition of deductible expenses in the relevant legislation. This is all the more the case because the expenditure is incurred in the course of winding up the business, rather than in the course of carrying on the business: *Modern Permanent Building and Investments Society (in liquidation) v FCT (1958) 98CLR187.*

3. As a result of section 8-1 ITAA 1997, the bonus is fully deductible to the employer. From the perspective of the employee, the bonus must be treated as assessable income, under either section 6-5 or 15-2. If the charitable institution to which the donation is made qualifies under Division 30 ITAA 1997, then the payment would be deductible to the employee in full.

   Section 6-5 (4) ITAA 1997 ensures that income is taken to have been derived by the employee as soon as it is dealt with in any manner that the employee directs.

4. Any interest paid on an overdraft is deductible under section 8-1, provided that the funds were used in the business to derive assessable income which does appear to be the case here. The fact that the security offered for the loan was of a private nature does not affect the deductibility of the interest as it is the purpose for which the borrowed money is applied that matters, rather than the security that relates to the loan – *Munroe v FCT (1926) 38CLR153*.

5. Provided that this can be characterised as expenditure incurred in the carrying on of a business for the purpose of gaining or producing assessable income, which does appear to be the case on the limited facts provided, the amount is deductible in full under section 8-1 (1).

6. Under section 25-30, legal expenses are deductible in full in the year that the costs are incurred.

7. The Cancer Council is a recognised charitable institution for the purposes of Division 30 ITAA 1997, and accordingly, a donation made, provided that there are no strings attached, will be fully deductible.

PART B

Question 3

The student should explain to the Head of the Foreign Treasury, that Fringe Benefits Tax, or FBT, was introduced in Australia with effect from 1 July 1987 as a separate tax to the ordinary income tax. It was introduced largely because the pre-existing income tax laws did not adequately deal with Fringe Benefits and, more importantly, the limited rules that did exist, were not fully applied by the relevant regulators.

It should also be explained that the income year for FBT purposes runs from 1 April to the following 31 March, which is out of line with the ordinary income tax year of 1 July to the following 30 June.

It should also be explained that the tax is levied on employers rather than employees. This creates a rather odd outcome in one respect – the party that receives the benefit is not the party that pays the tax. On the other hand, it adds some simplicity to the system, since an employer with 10,000 employees each receiving a fringe benefit would lodge one FBT return, disclosing all the fringe benefits provided to all its employees, rather than 10,000 FBT returns being provided by each and every employee. This provides for an easier audit check in relation to what has taken place.

Complexity is also added by virtue of the fact that there are 13 different classifications of fringe benefits with different rules for valuation and determination of FBT liability for each of those 13 classifications.

Complexity is also added because the value of the fringe benefit needs to be grossed up, taking into account any Australian GST that might apply. This creates tremendous complexity in the Australian Tax System.

For a tax that collects very little revenue (about 1% of total Federal revenue collected) this is a tremendously complex tax, which is not, strictly speaking, necessary. If a new system were to be introduced into the foreign country in question, it would be far simpler to have fringe benefits taxed as part of the ordinary income tax, collected from the employee in accordance with the income tax year, with any complicating rules of valuation embedded in the ordinary income tax system. This would eliminate the need for a separate tax year, and potentially separate rules. The valuation and gross up mechanisms should be simplified and streamlined so that they are more uniform across different classes of fringe benefits.

The Australian model should not be followed.

Question 4

Part 1

The sale of fruit by grocer is the sale of basic food and accordingly would be GST-free. This is designed to ensure that the less well- off are not unduly prejudiced by being subject to GST on basic food particularly since their expenditure on such items is much higher than the equivalent percentage for higher paid taxpayers;

The sale of books by a newsagent would be a supply carried on by an enterprise in the furtherance of a business, and accordingly fully subject to GST;

The provision of advice by a bank regarding a loan facility is the provision of advice for a fee and even though it relates to a loan facility, the advice itself would be subject to GST.

The export of raw materials by a mining company is an export and is accordingly GST-free. This is designed to ensure that exports remain competitive against competing countries;

The sale of a residential homes by a builder – depending on the precise circumstances the sale would be input taxed meaning the supply is not subject to GST and no input tax credits can be claimed. If however the home is new the input tax treatment does not apply and the sale will be subject to GST in the ordinary way. Supplies classified as input taxed are treated that way usually for policy reasons – namely that it is impracticable to make taxpayers who make supplies of residential rent or financial services taxable persons.

The lease of city office premises – as these are commercial premises the supply will be subject to GST in the ordinary way.

The provision of a medical consultation by a doctor is a health service which is GST-free. This is designed to ensure that the less well- off are not unduly prejudiced by being subject to GST on medical services particularly since their expenditure on such items is much higher than the equivalent percentage for higher paid taxpayers;

The provision of an education course delivered by a school would fall within the definition of an education supply and would be GST-free. This is designed to ensure that the less well- off are not unduly prejudiced by being subject to GST on education services particularly since their expenditure on such items is much higher than the equivalent percentage for higher paid taxpayers;

Part 2

The sale of a business as a going concern is a GST-free supply.

Five conditions must be met:

1. the supply must be for consideration;

2. on the day of the supply, the recipient must be registered or required to be registered for GST;

3. by the date of the supply, the parties must have agreed in writing that the supply is a supply of a going concern;

4. the supplier supplies to a single recipient everything that is necessary for the continued operation of the enterprise;

5. the supplier carries on the enterprise until the date of the supply

The GST free treatment of the sale of a going concern is designed to ensure that the purchaser of such a concern does not have to obtain additional funds to cover the GST included in the

price of the going concern. Another purpose is to prevent evasion. If a vendor charges GST it may not pay it to the ATO especially since the vendor is likely to be out of business and the amount would be quite large. The risk is overcome by both parties agreeing to not charge and pay GST.

PART C

Question 5

In broad terms, a partnership in Australia is not treated as a separate legal entity but rather as a look-through entity. Some exceptions apply, particularly for limited partnerships, and other special purposes partnerships which are sometimes treated as if they were companies.

More broadly, where you are dealing with a normal every day vanilla partnership, it is not the partnership that is taxed, but each partner within the partnership on the referable proportion of the partnership income. Where salaries are paid or drawings taken from a partnership, they would be treated as an advance against partnership income. Special rules apply to interest paid to or by a partner.

Generally speaking, partners cannot deal with the partnership other than by way of their partnership interest, although there are some exceptions where loans are made directly by partners to a partnership, even where it is a partnership in which the partner has an interest.

Question 6

Taxing distributions from discretionary trusts at a minimum 30% is a proposal that has been put forward by the political party. Farm trusts will be exempted from this treatment, although it is not at all clear what is meant by a farm trust. Will it be a trust in which any beneficiary might live and work on a farm? Or is it a trust in which one of the principal assets of the trust is a farm? This will be a critical definitional issue in the run up to the introduction of this measure, if it comes to pass.

There will be huge problems with this proposal in the context of small businesses, which regularly carry on activities of a business kind through a discretionary trust. Under the party's proposal, if $100,000 is distributed from a small business which is not a farm trust, to a beneficiary with no other income, that distribution will now be taxed at $30,000. Under current arrangements, the tax would only be in the region of $24,000 to $25,000. This represents an almost 25% increase in the tax liability, which will affect many, many small businesses throughout Australia.

A further definitional complication will be what is meant by a discretionary trust – what will be the position if there is a discretion as to the payment of capital, but no discretion in the context of distributions of income, or vice versa.

To what extent does there need to be a discretion embedded within the trustee in order for a trust to be a discretionary trust?

Question 7

Imputation is one of the least well understood areas of the Australian Tax System. Essentially it involves the presumption that any tax paid by a company will be imputed to the dividend that is distributed by the company to its shareholders.

Thus, to illustrate, if with the 30% corporate tax rate a company earns $100 and pays $30 in tax, when the $70 remaining is distributed to the shareholder, the tax paid by the company is imputed to the shareholder. This is achieved by treating the shareholder as having received $100, calculating the shareholder's tax on that $100 at the shareholder's relevant marginal rates, and then applying a credit of the $30 paid as company tax at the company level. If the shareholder was on a marginal rate of 45%, the tax due on the $100 that the shareholder receives would be $45 with a credit for the $30 already paid by the company. This would leave the shareholder with $15 to pay on that dividend.

By the same token, if the shareholder was on a marginal rate of 0%, the tax on the $100 received would be zero, a credit of $30 would arise, and there would, under current Australian arrangements, be a $30 refund provided to the shareholder.

The government proposes to deny refunds of excess imputation credits in the latter example just provided. In practical terms, what this means is that the shareholder will no longer receive that $30 refund. If the shareholder was relying previously on that refund for his or her everyday living, this will now cause significant detriment to that shareholder. To protect a large swathe of Australian taxpayers, anybody who is in receipt of an age pension, either in full or in part, or who was an age pensioner and a member of a self-managed super fund as at the date the announcement is made, may find, under the proposal, that they are exempted from the denial of the refund.

This will create considerable complexity in the Australian tax system, particularly in the carve out for age pensioners and self-managed super funds, and will create a lot of antagonism and envy within the system, as some people receive refunds and others do not.

Question 8

Generally speaking, foreign residents are taxed on income derived from Australia in one of a number of ways. First, in relation to interest dividends and royalties received, a withholding tax will normally apply within Australia. Thus, when paid out, interest will be subject to a 10% withholding tax, unfranked dividends and royalties to a 30% withholding tax, and franked dividends to a 0% withholding tax. This withholding tax system is being extended to some other classes of income, but broadly speaking, the most important ones remain interest dividends and royalties.

Secondly, there are some rather obscure provisions that tax by reference to a specific designated percentage – see for example premiums paid on insurance policies to non-residents.

Thirdly, capital gains are only taxed if they relate to taxable Australian property which is a defined concept in Section 855 ITAA 1997. This limits the exposure to capital gains largely to Australian land or buildings and shares in Australian companies and units in Australian unit trusts where the main assets of the company or trust in question is either Australian land and buildings.

Finally, where none of the above rules apply, because the income or capital gain for whatever reason is not covered by those rules, the broad principle is that Australia will only tax the income in question if it is earned from sources in Australia. The concept of the source of income is now largely a common law concept, and is a practical hard matter of fact (see Nathan's case) which requires the person to examine all the characteristics of the income and what the connections are to Australia. There is considerable case law on the point which would need to be consulted in any given case, see for example Efstathakis, Mitchums case, and French's case.