

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2024

MODULE 2.01 – AUSTRALIA OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

TIME ALLOWED – 3¼ HOURS

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

You need to answer **five** questions in total. You will **not** receive marks for any additional answers.

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 in Australian Dollars, unless otherwise stated. Any monetary calculations should be made to the nearest whole Australian Dollar. Any necessary time apportionments in your calculations should be made to the nearest whole month.
- 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 clarity of presentation of your answers.
- 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 questions in Parts B and C.
- There is no separate reading time, so you can start typing your answers as soon as the exam begins. However, we recommend that you set aside some time to thoroughly read each question and plan each of your answers.

PART A

You are required to answer BOTH questions from this Part.

1. Archer was born in Australia in 1970. While on holiday in Fiji he met Candice, a Fijian citizen, who subsequently moved to Australia with Archer; the couple married in 2000.

In January 2002 Archer put his apartment on the market but it failed to sell. In June 2002, with the benefit of an inheritance, Archer and Candice purchased another house in Melbourne, in their joint names, for \$500,000. Archer and Candice had one child in 2005, by which time all family members were Australian citizens, living in the same house which was their primary residence.

In 2012 Archer was offered a job in Fiji, and he and his family moved to that country both for work and to be close to Candice's relatives. Archer and Candice decided to rent out their Melbourne house through a local real estate agency.

The tenant who rents the house in Melbourne is an Australian resident health practitioner who uses 80% of the couple's residential property as a place of business, as the zoning and local council allow such commercial use. This tenant continued to occupy the property up to and including the current tax year, paying a total rent to date of \$300,000.

Candice and Archer have settled into their new life outside Australia and commenced a tourist business in Fiji, selling adventure travel packages within the Fijian islands. In 2023, while still in Fiji, Archer and Candice decided to sell their Melbourne house in order to finance an expansion of their business ventures in the Pacific region.

A real estate agent has advised the couple that the market value of their Melbourne house has risen to \$2 million. The house can be sold without marketing and through a private sale for that amount. However, Archer has decided not to sell his other Australian property, the apartment, until he can obtain professional advice on the tax consequences of selling this additional property.

The apartment has been unoccupied since Archer and his family left Australia, available only for short stays to wider family members when they visit the area. At the start of the current tax year, Archer's parents moved into the apartment, and they have since been living there rent-free. Archer seeks to claim a tax loss in the current year, claiming deductions for strata property charges and other property levies.

As a tax professional, you are required to advise Archer and Candice on the following tax matters in the current tax year:

- 1) **the tax residency status of Archer and Candice;** (5)
- 2) **the tax consequences, including Capital Gains Tax and Goods and Services Tax, of the planned sale of their Melbourne house; and** (15)
- 3) **whether the relevant tax laws allow Archer to offset a tax loss in respect to his apartment against his share of net rental income from the Melbourne house.** (5)

You may disregard any double tax agreement provisions between Australia and Fiji.

Total (25)

2. Irene, an Australian resident, was made redundant from her employment as a scientist with an Australian medical research company, Procedural Pty Ltd, on 30 June 2023, after a global restructuring of operations undertaken by a consultancy firm identified her specialist area for scaling down and determined that her position was no longer needed.

Irene had been in a senior research and development (R&D) position with her employer for many years and was provided with a generous package of income and property for her years of service.

As part of her separation package, Irene accepted a payment of \$200,000 as her share of an incentive profit participation payout agreement, with another wholly owned group entity related to her employer company. This amount was calculated as a 10% deferred payout against sales of an old out-of-patent blockbuster drug, with the agreement terminating her existing profit entitlements. The amount is to be paid in four quarterly instalments of \$50,000 in the following tax year. A further arrangement made was that Irene's company car, previously provided to her by Procedural Pty Ltd, would be transferred to her spouse on leaving the company under a transfer of lease arrangement.

In addition, without any separate payment being received, Irene had agreed to a 'restrictive covenant' under which she may not pass on her knowledge of any R&D work which she led at Procedural Pty Ltd for a period of three years following the current year of income.

Six months after being made redundant, Irene started up her own medical research company, called Invest&Go Enterprises, in partnership with an Indian medical research company. She is concerned and wants to avoid litigation resulting from her agreement with Procedural Pty Ltd not to pass on her 'know how' and has sought legal advice at a cost of \$25,000.

An international corporate lawyer has advised Irene on how best to restructure her affairs for future tax years, as well as on the scope of her restriction on employment clause signed with her former employer. The lawyer has assured Irene that her agreement with Procedural Pty Ltd is not a binding, worldwide restriction, and that she is free to undertake any medical R&D work in countries outside Australia.

Irene seeks your tax advice on the Australian tax treatment of each class of income and deductions outlined.

You are required to answer the following questions with respect to Irene's Income Tax liability:

- 1) **How is Irene required to treat the payment of \$200,000, received on her redundancy, for Income Tax purposes?** (10)
- 2) **How is the restrictive covenant treated for tax purposes, and can the \$25,000 outlay for legal advice be considered tax-deductible?** (10)
- 3) **What are the tax consequences of the transfer of Irene's company car from Procedural Pty Ltd to Irene's spouse?** (5)

Total (25)

PART B

You are required to answer ONE question from this Part.

3. The Taylor Discretionary Trust is a resident discretionary family trust which was created on 1 July 2022, with a corporate trustee, Glee Pty Ltd (Glee). The sole shareholder and director of Glee is Mike Taylor.

The beneficiaries of the trust include Mike and another company, Glee Investments Pty Ltd (Glee Investments), who have each been entitled to the income of the trust in the current 2024 tax year and previous two years. The net income of the trust for tax purposes is equal to the trust law income, in each of these tax years,

In each of the previous income years and the present year, loans of \$50,000 per annum were made by the trust to Mike and recorded as a debt accumulating in the accounts of the trust, under a seven-year loan agreement. The amount owing under the loan was forgiven in the current year.

The trustee, Glee, as allowed by the trust deed, also made some payments on behalf of the corporate beneficiary, Glee Investments, which reduced its entitlement to trust income in the current year, although half of its entitlement remains unpaid at the tax year's end.

The Australian Tax Office (ATO) has conducted a risk assessment and asked why no amount of assessable income has been returned for any of the unpaid entitlements in the tax returns of either Mike or Glee Investments.

You are required to advise the trustee of the Taylor Discretionary Trust on the tax implications of loans made by the trust to Mike and Glee Investments, indicating any differences in the tax treatment of the forgiveness of loan by the trustee to Mike and Glee Investments' unpaid entitlements, in light of the ATO's audit query. (20)

4. Glenice started work on 1 October 2023 as a superannuation fund auditor, providing auditing services to two self-managed superannuation funds through the Ice Family Trust, of which she is the trustee. Glenice obtained this work by referral from a friend who works as an accountant in the superannuation industry.

In the current tax year, as trustee of the Ice Family Trust, Glenice entered into two fixed service contracts to provide auditing services for the High-Net-Worth Super Fund, and for the Mum and Dad Superannuation Fund for specific regulatory audits. The accountant representing both superannuation funds provided Glenice with equipment and office space for use in conducting the work.

Under each of the two contracts, Glenice had the task of checking the accuracy of the financial accounts for the respective superannuation fund but had no liability for any alleged defects in her auditing work. The majority of income received from auditing the accounts of these self-managed superannuation funds is generated from Glenice's personal efforts. All of Glenice's income in the current tax year is derived from the Ice Family Trust.

Looking ahead to the tax year ending 30 June 2025, Glenice plans to increase her workload by advertising her services more widely through accountancy networks and with the expectation of greater profit being earned by the Ice Family Trust from her auditing work. Glenice seeks advice whether she would be entitled to split the future income of the trust with her five children, who are potential beneficiaries of the trust.

You are required to explain the applicable tax law, including any relevant case law, to Glenice in relation to her tax affairs for the current year and the proposed change in arrangements, including:

- 1) **Whether the Personal Services Income provisions may apply to Glenice and her current arrangement, and the resulting tax implications. You may disregard any Goods and Services Tax implications.** (15)
- 2) **Whether the Australian Tax Office may consider application of the general anti avoidance provisions to Glenice's income splitting proposal for the next tax year, and the basis on which such a decision would be made.** (5)

Total (20)

PART C

You are required to answer TWO questions from this Part.

5. Spirits Pty Ltd is an Australian resident company which began making a range of premium spirits for sale to independent bottlers in Australia on 31 October 2022, from a rural location which affords ready access to pure water, grain ingredients and botanicals. Sales turnover has been less than \$50,000 for the past year, but is forecast to double in the current year.

Spirits Pty Ltd is considering scaling up its production and expanding its sales to a distributor in the United States that is not registered for Goods and Services Tax (GST) purposes. The US distributor has proposed an arrangement under which it will purchase agreed annual volumes of matured spirits produced by Spirits Pty Ltd, once they have reached an agreed age, directly from Spirits Pty Ltd's warehouse in Australia. The US company will then arrange the cellaring of the spirits, and will be responsible for exporting the spirits to the US once the spirit has reached a certain maturity through cellaring.

On 1 July 2023, a contract was agreed with the US company to make three equal four-monthly payments for the spirits, with the final instalment to be paid within two months after the product being judged as ready for export.

You are required to explain the indirect tax responsibilities of Spirits Pty Ltd; whether it is carrying on a business with respect to the sale of premium spirits in Australia that is subject to GST; and the type of documentation needed to evidence overseas sales. You are not required to address Excise Duty or Wine Equalisation Tax. (15)

6. Freddie is a health professional working in a large hospital. Outside of his primary job, Freddie also undertakes work as an influencer, providing wellness recommendations on various digital platforms.

As he has become more well-known, Freddie has arranged his financial affairs so that his image rights, likeness and product approval stamp are held by a separate company, of which he is the sole director. Freddie's company charges a fee to anyone in the world who applies for the right to use his image, and he has appointed a manager to look after the use and exploitation of his image.

The Australian Taxation Office (ATO) has denied deductions for management fees claimed by Freddie in his tax return for the year ending 30 June 2023, and also assessed Freddie personally on the profits from exploiting his image rights.

You are required to advise Freddie on the available procedures to contest both the disallowance of management fees and the ATO's treatment of his worldwide image rights being sold by a separate related entity. You should explain the basis for any claims Freddie can make to the ATO, and any assumptions you make. (15)

7. A financial institution, Checko, is considering issuing a capital raising instrument that it intends to categorise as debt for tax purposes, in order for the associated expenses to be considered tax-deductible.

The proposal is for mandatory converting preference shares to be issued, which Checko will have an option to buy back before the date on which they convert into ordinary shares or, alternatively, at that date the mandatory converting preference shares will be swapped over for ordinary shares in a related company.

As a consultant to Checko, you are required to provide an overview of the debt and equity tax rules for the tax year ending 30 June 2023 and how the alternatives proposed would be determined under the applicable tax law. (15)

8. Austeria Pty Ltd is an Australian resident company. It directly owns 30% of the paid-up capital of a foreign company, Offshoreco, resident in a listed country, and also owns a further 30% of Offshoreco through an interposed group entity.

Offshoreco has attributable tainted income of \$1 million for the current statutory accounting period, and also has a notional allowable deduction of \$200,000 (based on the 20% rate of foreign income tax paid on foreign tainted income in the foreign jurisdiction).

As the internal tax adviser for Austeria Pty Ltd, you are required to explain the tax consequences of the controlled foreign company provisions and whether the entitlement to treat foreign attributable income as being paid has been met, including a calculation of that liability to Austeria Pty Ltd. (15)