

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2023

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 to the nearest month and in Australian Dollars, unless otherwise stated.
- 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. Dane is an Australian resident for tax purposes and has been employed in Sydney as an engineer with Highrise Solutions Pty Ltd, the Australian subsidiary of a large multinational construction firm, during the tax year ending 30 June 2023.

As part of his performance remuneration for the current tax year, Dane received rights to a parcel of shares under the Highrise Solutions Pty Ltd employee share plan, for which he paid a discounted price which was significantly less than the prevailing market price. Under the scheme rules, Dane is restricted from exercising his rights to sell these shares without the Board of Directors' approval, for the following two years. He intends to sell the whole parcel of shares worth \$10,000 once the restriction ceases.

On weekends, Dane plays football semi-professionally for a local club team, the Rockets, which contractually pays him for each weekly match in the league over the season. The player agreements specify that players receive fixed match payments of \$500 when included in the starting squad for the match, and bonus gift cards of \$200 are provided to players for winning a match. At the end of December 2022 Dane was awarded a new car worth \$30,000, for being elected by the local football association as the most valuable player in the league for the season.

In addition to his engineer's salary and football income, Dane owns a rural property on small acreage. He seeks to claim losses of \$50,000 for his yearly net losses in trying to establish a plant nursery business, although the business has not been commercially viable in the current tax year, nor in the previous two tax years. Dane argues that the continued and increasing losses were due to issues outside of his control, including climate change and the global pandemic, as well as his lack of experience in growing nursery plants on a large scale. Dane insists that he has tried his best to establish his business after completing several online horticultural tutorials, investing in online plant stock and trying to diversify into livestock.

Dane seeks your advice on the tax treatment of each class of income.

You are required to address the following issues concerning the income tax liability for Dane:

- 1) **What are the tax implications relating to the parcel of discounted employee shares received in the current tax year?** (10)
- 2) **What are the tax implications of Dane's football income from the Rockets, including the match payments, gift voucher win payments and car?** (5)
- 3) **What are the tax implications relating to the net business losses of \$50,000 from the plant nursery activities in the current year?** (10)

Total (25)

2. Two Australian resident siblings, Alfie and Bonnie, operate a commercial importing business with their American resident brother, Corban. Corban chose to join the business through his Limited Liability Company (LLC), which was formed in the United States and is not an Australian resident. ABC Partnership was formed on 1 July 2021, when the business commenced and the business was operated for the full tax year.

For the tax year ending 30 June 2022, the following financial details were agreed by the partners:

- 1) Alfie and Bonnie are each entitled to an equal, one-third share of the partnership's net profits of \$300,000, while a dividend amounting to a one-third share of the net profits is paid to Corban's LLC. Bonnie is not involved in the business and has entered into a deed with the other two partners, so that her share in the net income of ABC Partnership will be credited to a drawings account. The deed also limits Bonnie's ability to withdraw her share of the partnership income or dispose of her one-third partnership interest.
- 2) The partners agreed that for the 2022 tax year, Alfie was paid a salary of \$40,000 as he took on the responsibility for the business accounting functions, while Corban was paid a salary of \$20,000 for his client engagement service activities, which assisted the business to grow its client list. Some superannuation was also contributed to a superannuation fund for Alfie at the rate of 9.5%.
- 3) Loan totalling \$35,000 were taken out by ABC Partnership with Commerce Bank on 29 June 2022 at a market lending rate of 5%, in order to provide working capital for the partnership of \$15,000 and to provide an onward loan of \$20,000 to Corban that would enable him to pay out his revalued partnership capital. The onward loan from ABC Partnership to Corban was lent at a 1% interest rate.

You are required to explain the following issues, with reference to Australian tax law, which affect the income tax liability of partners in respect of ABC Partnership income for the 2022 tax year:

- 1) **How is ABC Partnership treated for tax purposes, including the tax liability of the partners in relation to the partnership's net income?** (10)
- 2) **Discuss the tax treatment of the salaries paid to Alfie and Corban and the superannuation contributions for Alfie, and their effect on the partnership's net income.** (5)
- 3) **Determine the extent of any deduction in respect of loans from Commerce Bank and the tax treatment of the on-lending to Corban. You may ignore any double tax agreements.** (10)

Total (25)

PART B

You are required to answer ONE question from this Part.

3. Landco Pty Ltd purchased a residential building block in a coastal mining town in 2020. It was an attractive purchase as the block of land was situated near a proposed new airport site. Landco Pty Ltd intended to convert the building into residential and business premises, upon subdivision approval and the completion of upgrades to the power supply, and to lease out the premises to residential and business clients. Landco Pty Ltd also intended to hold and occupy two units in the building and had not intended to sell any part of the building.

This was proposed to be a strategic, long-term investment in property for Landco Pty Ltd, which is a fully input taxed enterprise.

On 1 July 2021, after renovations were completed, the building was offered for lease and a mining firm took over the whole building leasehold for its fly-in-fly-out employees. Rental income was received for one year; the amount received was equal to, and offset by, the total of interest paid on funds borrowed to buy and develop the land and other expenses.

In June 2022, following a downturn in market conditions that affected Landco Pty Ltd's liquidity, the company sold the building for a profit after it received a strong purchase offer and after a government announcement that the proposed site for the airport was to be relocated to another preferred location in another suburb.

You are required to explain the income tax and GST implications of the sale of the building by Landco Pty Ltd. (20)

4. A resident discretionary family trust, the Frills Family Trust, has been created with three beneficiaries: Frieda Frills, Freddy Frills and Kids Charitable Trust. The two individuals are resident adults, and the Kids Charitable Trust is a private not-for-profit entity established by the Frills family to benefit children with learning disabilities, although not registered with the Australian Charities and Not for Profits Commission.

The trust estate reports a net income from rental for the tax year of \$50,000 and capital gains of \$190,000 from property sales.

At the end of the tax year, the trustee resolves to distribute one half of the capital gain, \$95,000, to the capital beneficiary, the Kids Charitable Trust. The income distribution of \$50,000 is to be shared between Frieda and Freddy, who have other personal business tax losses to offset their share of net income of the trust.

You are required to discuss the tax treatment of the net trust income of the Frills Family Trust, and the adequacy of the tax strategy in channelling capital gains and income to different classes of discretionary beneficiaries. (20)

PART C

You are required to answer TWO questions from this Part.

5. Reef Tours Pty Ltd is an Australian resident company and a subsidiary of a foreign parent, Service Holdings Inc., located in the country of Hotania. Reef Tours Pty Ltd carries on the business of tourist boat cruises on the Great Barrier Reef area of Queensland for the current tax year. It operates ten vessels, year round, under a lease agreement. The business turnover has tripled in the current tax year and the company is considering doubling the number of operating vessels.

Under the master lease, Service Holdings Inc. leases the boats to another group company, Explora Inc., which is also a resident of Hotania and subject to a concessional 9% tax rate. Explora Inc. sub-leases the boats to Reef Tours Pty Ltd for \$250 million per year. Reef Tours Pty Ltd makes significant tax losses on its business tourist operations as a result of the sub-lease contract, while Explora Inc. charges significant additional fees for sub-lease services such as insurance, over and above what it pays under the master lease agreement with Service Holdings Inc.

The directors of Reef Tours Ltd seek your advice in relation to whether, as a significant global entity, it is likely to be exposed to the provisions of the Diverted Profits Tax.

You are required to discuss the application of Australia's Diverted Profits Tax to the arrangement, disregarding any double tax agreement implications, and explain the possible tax implications for Reef Tours Ltd. (15)

6. Zero Pty Ltd is a resident of a foreign country and operates a web business with a substantial number of subscribing Australian customers. Zero Pty Ltd's directors are aware that another associate competitor group company with a similar business model, Heroine Holdings Ltd, has received a written private tax ruling in 2019 from the Australian Taxation Office (ATO) that it is a non-resident for tax purposes and does not need to return Australian subscriber payments.

Under a self-assessment system of taxation, the directors of Zero Pty Ltd believe they should be able to rely on the private ruling advice received by Heroine Holdings Ltd, even though they understand there could be an inconsistent later general ATO public ruling on the technical aspects of tax residency that might not support their general circumstances of non-resident status and/or receipt of non-Australian source income.

The directors of Zero Pty Ltd do not want to go to the expense of applying for a private ruling, as the company considers that the Commissioner has already considered the same kind of issue and would be bound to follow the advice in respect of Zero Pty Ltd in the event of an Australian tax office audit.

As the in-house tax manager for Zero Pty Ltd, you are required to discuss the main features of ATO rulings, including the binding nature of income tax rulings issued by the ATO, whether Zero Ltd can rely on the private tax ruling issued to Heroine Holdings Ltd for tax purposes, and how best to achieve certainty for future tax years. (15)

7. Ancient Group was consolidated for domestic tax purposes on 1 July 2022, with Zeus Pty Ltd, an Australian resident, as the head company and X Pty Ltd as its 100% owned subsidiary member company under s.703-15 of the Income Tax Assessment Act 1997. Both entities operated in the same industry.

A revenue loss was transferred from Ancient Group subsidiary member X Pty Ltd, to the head company, Zeus Pty Ltd, at the time of consolidation. For the purposes of determining the amount of transferred tax losses that can be utilised, an available fraction of 0.425 is established for the bundled X Pty Ltd losses, which amounted to \$6million at the initial transfer time.

Modern Group, an industry competitor operating a profitable business, then acquired all shares in Ancient Group on 30 July 2022. At the time of takeover, the market value of Ancient Group was \$10 million and, following the takeover, the market value of Modern Group was \$30 million. On 30 June 2023, X Pty Ltd was liquidated and left the consolidated group.

You are required to provide an overview of the Australian consolidation rules, how they allow for the utilisation of losses, and the approach used for determining the proportion of losses available to the head company of Modern Group for the tax year ending 30 June 2023. (15)

8. Brick Pty Ltd provided a short term loan of \$20,000 to one of its long-term employees, company accountant Geraldine, on 1 March 2021 to help her overcome personal financial difficulties after interest rates had increased on her bank home loan. The loan was repayable in 12 months.

On 31 May 2022, Geraldine had managed to get her finances in order by renegotiating her bank loans and Brick Pty Ltd decided it would forgive half the \$20,000 loan and any interest that would have accrued for the year as Geraldine has been a loyal and otherwise diligent employee. Brick Pty Ltd did not take action to pursue the loan owed by Geraldine for the remaining 50% (\$10,000) and wrote it off as unrecoverable on the same day.

As Brick Pty Ltd, external tax adviser, you are required to explain the tax consequences of the loan and partial write off transactions to the company in the current tax year. You are not required to calculate the final fringe benefits tax liability, but should include discussion of relevant methodology.

(15)