THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2022

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.
- As you are using the online method to complete your exam, 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. SunnyCo is the head company of a yacht manufacturing group which is a non-resident of Australia and is located in Singapore. As SunnyCo has no enterprise or presence in Australia, it commissions an independent Australian broker to sell finished yachts to Australian customers and also sells yachts directly via an internet platform.

The broker sold ten yachts in the tax year ending 30 June 2022 for a total of A$10 million, and was owed a commission of 5% of the sale price. The broker retained the commission fee due of 5% on each yacht sold and, after paying customs duty, transferred the remaining net sales profits directly into SunnyCo's Australian bank account. SunnyCo then repatriated this income to its account in Singapore.

SunnyCo has also entered into a contract with unrelated repair company, Marine Pty Ltd, to service its yachts during the three-year warranty period in which defects would be rectified by the manufacturer, as well as to provide advice on any technical upgrades to its engines. Marine Co was paid a retainer fee of A$20,000 for the tax year, although no claims were made by any customers and no repairs were made under the warranty arrangement.

In the tax year ending 30 June 2022, SunnyCo made a foreign exchange loss of A$80,000 on its Australian transactions, settled a legal dispute with an Australian designer who claimed the company has infringed on a patented rudder design by payment of A$100,000, and paid a fine of A$5,000 to authorities for failure to comply with an import regulation.

You are required to advise SunnyCo on its Australian income tax obligations for the year ending 30 June 2022, and explain what amounts are to be included in its assessable income, with regard to:

1) The income of A$10 million from the yacht sales to Australian customers, ignoring any permanent establishment issues. (5)

2) The particular expenses incurred, which comprise:

a) Compulsory Customs Duty at a rate of 5% on the value of imported goods;

b) A retainer fee of A$20,000 paid to Marine Pty Ltd for service expenses; and

c) A requirement to draw up a plan for future investments;

d) The settlement payment of A$100,000 to the designer; and

e) The A$5,000 government import fine.

(10)

3) Whether, based on the facts, SunnyCo is liable for any Australian GST obligations under the *A New Tax System (Goods and Services Tax) Act 1999* (the *GST Act*). You should assume that the yachts are not re-exported by the customers. (10)

Total (25)

2. Spinner Communications Ltd (Spinner) is a medium sized, established Australian communications company which has been in business for ten years and in 2021 recorded a turnover of A$30 million. The Board of Directors of Spinner has decided to reposition the company for the future by expanding its capacity to take advantage of opportunities in the Australian space sector.

The company has raised capital for the expansion of its operations into satellite data centres, which will communicate with orbiting satellites and enable Spinner to charge for related services. Spinner also intends to build its capability to partner with companies launching satellites into low Earth orbit, and has joined a political lobbying group to advocate for the sector. It has negotiated a forward contract from the 2021/2022 tax year with a private equity firm for building four data centres, of which two will be located in New South Wales and two on a friendly Pacific island at a total cost of A$200 million, with an effective life of ten years.

Some costs were incurred in determining how to set up the move to a new business model, along with other operating expenses, including the following:

1) Research and development costs of A$175,000 for in-house space expertise to be brought up to the necessary standards and the development of new software.

2) A $4,000 levy to join the lobbying group, the Association of Satellite Providers, which seeks more government grants for space exploration start-ups; the levy includes a 10% contribution which is paid to political parties.

3) Costs for preparation of documents for a debenture issue to raise funds, and costs incurred in amending a company memorandum and changing Spinner’s Articles of Incorporation to allow for greater scope of high technology investments.

4) An exchange gain from sale of shares in a United States-based corporation of A$10,000.

You are required to advise Spinner of the taxable consequences and tax treatment of:

1) The initial $200 million investment in data centres. You should advise on the broad operation of any tax concessions available. (10)

2) The operating expenses, listed 2) to 4). You should advise, providing your reasons, on whether Spinner can claim a deduction in the tax year, for each category of expenditure. (15)

Total (25)

PART B

You are required to answer ONE question from this Part.

3. Jackson is a doctor, based in Australia, who runs a busy medical practice with three other doctors in Sydney. The four doctors started the practice in 2002. Due to health issues, Jackson recently decided to sell his partnership share to the remaining partners.

   On 1 February 2022, Jackson received A$210,000 in payment for his 25% share, of which A$20,000 was the indexed cost base share of partnership assets and A$40,000 was in respect of goodwill.

   The payment also included A$10,000 in settlement of a court action taken against the medical practice, requiring the other three partners to pay Jackson for lost profits not paid during a period of his illness.

   The remaining partners also included a clause in the sale agreement, under which Jackson was restrained from opening another medical practice within 10km of the old practice for the next two years. Jackson subsequently breached this clause and opened a consultancy in June 2022. No action to challenge this breach has been taken by the partnership to date.

   You are required to advise Jackson of the tax consequences of the sale of his partnership share, and how to calculate any assessable amounts for his tax return for 2022. (20)

4. Zee Pty Ltd (Zee) is a private company incorporated in Australia and a resident for tax purposes. In the tax year 2020, the bookkeeper for Zee left suddenly after an audit of the accounts identified issues relating to dividend payments and possible non-compliance with the tax laws regarding the imputation rules.

   The directors of Zee intend to pay a fully franked dividend of A$100,000 to all ordinary shareholders out of the current year's profits, and A$20,000 to partly paid shareholders. They have a benchmark tax rate of 30%, and seek your advice on the proposition and whether they are likely to incur any penalties should there be an insufficient balance to fully frank the dividends, especially given the uncertain business outlook.

   You have reviewed the following relevant transactions:

   1) On 20 August 2021, a PAYG instalment was paid to the Australian Tax Office of $15,000.

   2) On 9 September 2021, a notice to pay franking deficits tax of $10,000 was received and paid.

   3) On 1 April 2022, Zee received a $70,000 partly franked distribution from Abco Pty Ltd. which was franked to a proportion of 80%.

   You are required to explain the general operation of franking accounts to the directors of Zee, under the relevant provisions of the Income Tax Assessment Act 1997.

   You should include an overview of how the three relevant transactions that you have reviewed are accounted for, the broad implications of a foreshadowed, fully franked dividend to shareholders, and the implications of exposure to Franking Deficit Tax. (20)

PART C

You are required to answer TWO questions from this Part.

5. After ten years of full-time service, Jill plans to retire from her job in the food industry before her 40th birthday. Her employer no longer needs her position after a reorganisation, and has promised Jill that if she leaves by 30 June 2022, she will be offered a redundancy package of A$20,000 to be paid in three annual instalments. Jill would also receive unused long service leave of A$5,000 and a gold watch valued at A$1,000 on the day her employment ceases.

   You are required to explain the extent of tax liability for the 2022 tax year, relating to the benefits that Jill expects to receive on taking up the offer to cease employment. (15)

6. Jacob has been living with his mother in Germany and is aged 21. In the tax year ending 30 June 2022, he has received a distribution from a family trust created by his grandfather. The only other beneficiary to receive a distribution is Jannika, an Australian resident aged 16. The only income of the trust for the tax year was a gain of A$200,000 from the sale of private company shares held by the family discretionary trust for the past 15 years and paid out in equal proportions to the two beneficiaries.

   You are required to explain how the Australian tax liability of the trustee and beneficiaries is determined, in respect of their share of income received from the trust? (15)

7. An Australian entity, Whatco Pty Ltd (Whatco) controls a 100% foreign entity, Modulus, operating in the Cook Islands. Whatco is in receipt of income from dividends and interest on loans from Modulus, as well as income from a tourist operation on Cook Islands.

   You are required to consider the corporate tax implications for Whatco of the income received through Modulus. (15)

8. Meltingpot Inc. is a manufacturing entity that has issued a series of financial instruments to its Australian resident associate, X Pty Ltd, which are treated as debt for domestic tax purposes in Australia and are income assessed at a tax rate of 5% in the country that issues the instrument.

   You are required to describe the basis on which the Australian Tax Office would be expected to apply the hybrid mismatch rules to prohibit deductions in Australia. (15)