Answer-to-Question-_1_

Part (1)

Regarding the tax residency status of Archer and Candice, we consider factors as given at s 6(1) ITAA 1936, namely, the 4 exhaustive tests of residence of individuals such as

- if individual is resident of Australia as per ordinary concepts
- if individual is domiciled in Australia unless it is determined that the person's place of abode is outside Australia
- the 183 days test unless the indviduals do not intend to take up residence in Australia
- the individual is a member of certain Commonwealth government superannuation scheme.

In this case, Archer and Candice are domiciled outside of Australia as they are settled in Fiji. They are tax residents of Fiji. Hence, in Australia, they will be taxable only on Australian-sourced income such as rental or capital gains tax.

Part (2)

Archer and Candice will claim the main residence exemption on the sale of their Melbourne house when they realise a capital gains on the sale of the house. However, this is reduced for any period during which it was on rental.

The sale of a residential property is input-taxed to the extent that it was used predominantly for residential accommodation so that no GST will be applied.

Part (3)

Archer has two property at his disposal for rental and earning rental income. Thus, if he is in the business of property rental then he can deduct losses from one property agaist another. However, this is possible only when Archer is conducting a property rental business.

Answer-to-Question- 2

Question 2

Part (1)

Irene received $ 200,000 on her redundancy as her share of an incentive profit participation payout agreement. The amount was calculated as a 10% deferred payout against sales of an out-of-patent blockbuster drug. After this, she will not be entitled to further profit entitlements.

The amount will be paid in four quarterly instalments in the next tax year.

We need to assess whether the payment to Irene is a genuine redundancy pay as such a payment is tax free up to the limit imposed under s 83-170 ITAA 1997. But a genuine redundancy is one where an employee's position is genuinely redundant. Here we are told that Procedural Pty Ltd is undergoing a global restructuring and hence the position of Irene has been identified as no longer needed.

In case of a genuine redundancy, the payment to Irene will be subject to a tax free amount of

Base amount + (Service amount * Years of service).

For year 2023-24, the base amount is $ 11,985 and the service amount is 5,994. The tax free amount of a redundancy payment is regarded as NANE income.

However, to qualify as a genuine redundancy payment, Irene has to meet the conditions such as her dismissal occurring because of the redundancy of her position, and also conditions given at s 83-175(2) of ITAA 1997. We assume that as the position of Irene will be redundant and not that she will simply be replaced (*Weeks v FCT (2012)*).

In amount in excess of the tax free amount assuming genuine redundancy payment will be taxed as employment termination payment (ETP). The amounts will be taxed in the tax year in which they are received on a cash basis.

<u>Part (2)</u>

Irene had agreed for a restrictive covenant not to pass on her knowledge of any R&D work which she led at Procedural Pty Ltd for a period of 3 years following the current income year. She did not receive any separate payment for this restrictive covenant.

Six months after her redundancy, Ierene started her own medical research company and she sought legal advice at a cost of $ 25,000 whether she is breaching the restrictive covenant for non-competition with the for employer Procedural Pty Ltd.

Any payment received as part of a restrictive covenant so as not to compete with the payer is of a capital nature. This gives rise to a contractual right.

However, in the case of Irene, it is not clear what amount should be attributed to the restrive covenant that she received from her former emloyer. Consideration is important for the formation of contractual rights and obligations.

To consider past case law on restrictive covenants, in Reuter v FCT (1993), a covenant between employee and employer against a payment so as not to sue under a different contract was held as income per ordinary concepts as the services were closely linked to employment services.

If the amount under the restrictive covenant can be ascertained, it is likely to be considered of a capital nature as Irene is not supposed to compete with her former employer for 3 years after this income year. Further, despite the advice of the lawyer, she is based in Australia and so is assumed to be her company Invest&Go Enterprises.

Whether the legal cost of $25,000 will be tax-deductible depends on whether it meets the definition of a deduction under s 8-1 ITAA 1997 and subject to the negative limbs at s 8-1(2) ITAA 1997. Legal expenses related to the advice sought by Irene may be viewed as of a capital nature as it relates to defending her rights to compete. Hence, there is no immediate benefit to her business at this point of time. In prior cases such as John Fairfax & Sons v FCT, and Broken Hill Theatres v FCT, legal costs incurred to defend competition were regarded as of a capital nature.

Part (3)

Procedural Pty Ltd transferred the company car used by Irene into the name of her spouse when she left the company under a transfer of lease arrangement.

The company car transfer to Irene's spouse is a fringe benefit as under the Fringe Benefits Tax Assessmment Act 1986 (FBTAA).

The company car is benefit which has been transferred to an associate of Irene who is her spouse as the car is being transfererd with regard to the past employment of Irene who is now being made redundant. Thus, Procedural Pty Ltd will be fringe benefit tax with regard to the car that has been transferred. The applicable fringe benefit tax year in this case is from 1 April 2023 to 31 March 2024 given that Irene has been made redundant on 30 June 2023 and this is when we assume that the car was transferred. The value of the car will be in excess of $300 so that it cannot be disregarded for fringe benefits tax purpose.

Fringe benefits tax will be charged on the taxable value of the car at 47% which is the rate as per the FBTAA and it is payable by Procedural Pty Ltd. Irene or her spouse will not be liable for tax on the car.

Answer-to-Question-4

Question 4

Part (1)

A personal service income (PSI) is income earned by a tax payer predominantly through his or her own personal efforts. For instance, in this casem Glenice is providing her services, exercising her skills and through her labour she is deriving income. The issue with PSI is that the income can be assigned to other parties to avoid paying taxes.

There are specific rules in Div 84 to 87 of the ITAA 1997 dealing with PSI. If an entity such a company or a trust derives income that is regarded as PSI of an individual, then the income is attributed to that individual unless the entity is carrying on a personal services business.

Thus, there are certain tests to be conducted to check whether an individual is conducting a PSI business on his/ her own or whether it is a personal services business so that certain costs can be deducted.

As per the rules on PSI under ITAA 1997, the tests are a result test, unrelated client, employment and business premises tests.

The results test is the most important and if it is met, then the PSI rules do not apply. It is satisfied if for at least 75% of the personal services income, the the income is paid for producing a result, the individial has to provide the plant, equipment and tools to perform the work, and the invidual or entity is liable for the cost of rectifying any defective work.

The unrelated clients test is satisfied if the individual or entity provdides services and derives income from 2 or more unrelated clients, and the services are provided as a result of direct advertising and offering of the services to the public at large.

The employment test is satisfied if the individual engages the services of one or more other entities (except for his/ her own associates) to perform at least 20% of the market value of the work. And the business premises test is fulfilled if in an income year, the individual or personal services entity (PSE) maintains and uses business premises at all times during the income year, and PSI is derived from these premises, the individual or PSE has exclusive use of the premises and the latter should be separate from the private premises of the individual or PSE.

In the case of Glenice, the PSI provisions are likely to apply as from the facts it is difficult to maintain that she is conducting a personal services business. Hence, her income is likely to be held to be personal servces income arising from the personal efforts of Glenice herself. Regarding the results test, she is not tasked with producing a particular result and her pay is not related to this result. Rather she gets paid for reviewing the accounts and ensuring their accuracy. Thus, her tasks and pay structure are not time-bound and results based if we take a strict view.

We do not have enough information to gauge if the two clients are related or not, but they have been referred to by her accountant friend. Glenice did not subcontract and take the assistance of anyone else to conduct the work for the two clients and she expended her own personal efforts. Also she did not use any business premises to conduct the work except for the equipment and office space put at her disposal by her accountant friend, and she is not responsible for any defective work.

Thus, Glenice is not conducting a personal services business, but rather she is generating personal services income and she will be subject to the statutory restrictions under Divs 84 to 87 ITAA 1997.

Part (2)

While Glenice has plans for the tax year ending 30 June 2025 to increase her income by advertising her services more widely and increasing her workload, the ATO may apply the general anti avoidance provisions to Glenice's income splitting proposal.

While Glenice will be providing the services and earning the personal services income, splitting her income with her five children will result in tax avoidance as some of them may still have income below the tax threshold and lower income tax rates may be applicable for others. Hence, the PSI rules are likely to be applied as the employment test fails here. None of the children is likely to be involved in providing the services to Glenice's clients.

Answer-to-Question- 5

As per the facts of the case, Spirits Pty Ltd (Spirits) is not currently registeted for GST. However, since sales in past year has been less than $ 50,000, but it is expected to double during this year, thenwe we expext Spirits' sales to be at least $ 100,000.

Since the GST registrable threshold for GST is $75,000, Spirits has to register for GST under the A New Tax System (Goods and Services Tax) Act 1999 (the GST Act). The entity has to register as the sale of spirits is a taxable supply and hence it is subject to 10% GST when sold by an entity registered for GST or required to be registered for GST as it meets the $ 75,000 registrable turnover threshold.

Selling Spirits in Australia is supply in the indirect tax zone and hence GST applies. Spirits meets the s 9-5 GST Act conditions of taxable supply, namely, supply made for consideration, supply is made in the course or furtherance of an enterprise carried on by the entity, teh supply is connected with Australia, the entity is either registered for GST or required to be registered.

The arrangement with the US distributor is an exports. Exports are GST-free so that Spirits will not have to apply GST on export sales.

The sales will be evidenced by the invoice that Spirits will issue to the US distirbutor. While the goods will be in Australia for some time, their ownership would have changed. A supplier is taken to have exported goods if they are supplied to an unregistered entity in Australia prior to export which in turn exports them. But the supplier must have sufficient documentation to show that the goods were exported, and the goods are considered as having 'entered for export'. As per GST law, to be eligible for GST-free treatment, an export must occur before or within 60 days after the earlier of the day on which the supplier receives the consideration, or the day on which the supplier gives an invoice.

However, given the arrangement between Spirits and the US distributor, the spirits will not be exported so soon. Hence, while the payment wil be treated as advance payment by the US distributer to Spirits, exports will occur only when the spirits will be shipped to the US and at that point all export documentation such as export invoice, bill of lading and other shipment documents will be available to substantiate the export sales.

Answer-to-Question-_7_

Question (7)

The debt and equity rules are given in Div 974 ITAA 1997. The rules guide in classifying shares in a company and financial instruments as debt or equity. These rules aim at providing test to distinguish between debt and equity so that the transactions reflect the economic substance of the interest in terms of its impact on the issue of that interest.

The debt equity tax rules will apply in this case as the proposal is a scheme regarding a financing arrangement. As given in the scenario, Checko is considering whether to issue debt in order to raise capital as the interst on the debt are tax-deductible.

The debt and equity classification divide schemes into debt interests and equity interests. An equity interest occurs when the interest is in an entity that is taxed as a company. If an interest satisfies both the equity and the debt test, it is treated as a debt interest.

A scheme is a debt if it is a financing arrangement, the entity or its associate will receive a financial benefit, the value provided is more or less equal to the value received. An equity interest is an interest that is not a debt interest, but it is also charactrised as giving the right to variable return on the investment, return at the discretion of the company, it is an interest in a company, among others.

Checkco's intention is important regarding its intention behind the raising of the finance and the form that the financing arrangement will take. In case, it does not intend to convert the shares into ordinary shares, then it is likely a debt scheme so that interest payments are tax deductible. On the other hand, converting shares into ordinary shares indicate an equity scheme.