

LEGAL PROFESSION ADMISSION BOARD

MARCH 2009

TAXATION AND REVENUE LAW

TIME: Three Hours

This paper consists of **six** questions.

Candidates are required to attempt any **four** questions.

All questions are of equal value.

If a candidate answers more than the specified number of questions, **only** the first **four** questions attempted will be marked.

All questions may be answered in one examination booklet.

Each page of each answer must be numbered with the appropriate question number.

Candidates must indicate which questions they have answered on the front cover of the first examination booklet.

Candidates must write their answers clearly. Lack of legibility may lead to a delay in the candidate's results being given.

Permitted Material:

This is an open book exam. Candidates may refer to any books and any printed or handwritten material they have brought with them.

As some instances of cheating and of bringing unauthorised material into the examination room have come to the attention of the Admission Board, candidates are warned that such conduct will result in instant expulsion from the examination and may result in exclusion from all further examinations.

This examination should not be relied on as a guide to the form or content of future examinations in this subject.

Question 1

The "Happy Pets" was a weekly magazine devoted exclusively to providing information to pet owners. The magazine was published by World Publications Limited ("World Publications"), a company which, in addition to the magazine, also published a Sunday newspaper, "World Affairs" which was devoted to current affairs.

In an article in the January 2004 issue of "Happy Pets" the editor said that a certain animal food was dangerous to dogs and accused the Australian manufacturer of the food of being irresponsible. The manufacturer of the dog food successfully sued World Publications for damages for defamation. The dog food was in fact quite harmless to dogs. Judgment for \$40,000 was given in April 2006. The judgment was made up of \$30,000 for loss of profits and \$10,000 for damage to goodwill. World Publications had ceased to publish "Happy Pets" in February 2004 but still continued to publish the "World Affairs".

From February 2004 until February 2008 the former editor of "Happy Pets", Smith, remained in the employment of World Publications. He was assigned to, and devoted all of his time to, investigating the finances and prospects of several magazines published by other companies that World Publications was interested in acquiring. In February 2008 World Publications purchased "Cuddly Animals", a magazine devoted to care of domestic pets.

Consider the tax implications of the following:

- (a) The deductibility to World Publications of the legal expenses connected with the defamation litigation;**
- (b) The deductibility to World Publications of the judgment of \$40,000;**
- (c) The assessability of the dog food manufacturer in respect of the judgment of \$40,000;**
- (d) The deductibility to World Publications of the salary paid to Smith for the period from February 2004 to February 2008;**
- (e) The deductibility to World Publications of the office expenses that related to Smith's activities for the period from February 2004 to February 2008;**
- (f) The deductibility to World Publications of the purchase price paid for "Cuddly Animals".**

(25 marks)

(Question 2 follows)

Question 2

Part A

Mary and Kathryn are two school teachers who have a good general knowledge. Both decide to enter into a television quiz show called "Brains of the Century". Under the rules the contestants receive a gold medallion worth \$500 for an appearance. If they answer the questions correctly they receive substantial cash prizes and also other prizes such as household goods and trips overseas. The trips may not be transferred or redeemed, but may be converted into alternative trips of equivalent value.

Mary and Kathryn go on the show. Mary is eliminated after the first show and receives the gold medallion but nothing else. Kathryn is successful and makes ten appearances over ten weeks. After the first show she becomes so confident of further success that she spends some time studying topics which she believes may be the subject of questions on the show. Mary eventually wins cash of \$5,000, household appliances worth \$10,000 and a trip to Europe for two including accommodation worth \$20,000.

Advise Mary and Kathryn of the assessability of the prizes.

(15 marks)

Part B

In June 2007 Richard enters into a contract for service for seven years as managing director of International Pty Limited ("International") at a salary of \$150,000 per year. International pays Richard a "premium" of \$20,000 as consideration for him entering the contract. Richard pays his lawyer \$1,000 to review the contract before signing it.

After one year Richard receives a better offer from another company. International agrees to release Richard from the contract if Richard makes a payment of \$100,000 for the release. Richard makes the payment of \$100,000 and is released.

Advise Richard and International of the tax implications of entering into the contract and the release. What would be the tax implications to International if Richard did not receive a better offer from another company and stayed with International for the whole term of his contract?

(10 marks)

(25 marks)

(Question 3 follows)

Question 3

John Brown died in Sydney on 1 January 2001.

In his will, John:

- (a) Gave his property "Brownvilla" to his wife Jane absolutely, and
- (b) Gave the balance of his estate to his solicitor, Alex Trusty, to be held by him upon the following trusts:
 - (i) To hold one half of the estate for Jane for life and, after her death, for her twin daughters, Hope and Charity, absolutely in equal shares, and
 - (ii) To hold the other half of the estate for such of Hope and Charity who attain 18 years (and, if more than one, in equal shares) and if they should both die before attaining 18 years the estate is to go to charity.

The will also provides that one half of the net income of the trust estate has to be distributed to Jane each year but gives Alex (the trustee) a discretion as to whether or not to apply either the whole or part of the other half of the net income of trust estate for the benefit of Hope and Charity. To the extent that he does not apply the other half of the net income to the benefit of Hope and Charity the will provides that the amount is to be accumulated until (and if) Hope and Charity attain 18 years.

Hope and Charity were 8 years old at the date of John's death.

John had acquired "Brownvilla" on 1 January 2000 for \$50,000. On 1 January 2001, it had a market value of \$100,000. It was transferred to Jane on 1 January 2002, being the day on which administration of the estate was completed.

During the year of income ended 30 June 2007, Alex received, on behalf of the estate the following amounts:

- (a) \$12,500 being unfranked dividends;
- (b) \$10,000, being interest;
- (c) \$15,000 being rent from properties.

During the same income year (30 June 2007), Alex on behalf of the trust estate incurred administration and accounting costs of \$2,500 and invested \$5,000 in the acquisition of shares.

In accordance with the terms of the will, Alex distributed one half of the income of the trust estate for the year of income ended 30 June 2007 to Jane. Alex also paid \$5,000 each (\$10,000 in total) out of the remaining income of the trust estate for the year ended 30 June 2007 on account of school fees for Hope and Charity.

(Question 3 continues)

(Question 3 continued)

During the year of income ended 30 June 2007, Jane sold Brownvilla for \$150,000.

What are the tax consequences of these facts in relation to the year of income ended 30 June 2007?

(25 marks)

Question 4

Kars Limited ("Kars") is a public company engaged in the manufacture and sale of motor vehicles. Kars also owns shares in two public companies called Alpha Limited ("Alpha") and Beta Limited ("Beta"). The shares in Alpha and Beta had only been held by Kars for two years prior to sale in the 2008 year of income. For the year ended 30 June 2008 Kars has the following receipts and outgoings:

Receipts:

Sales revenue	\$2,050,000
Fully franked dividend from Beta	\$14,000
Partially franked dividend from Alpha (Franked to 50%)	\$28,000
Proceeds from the sale of shares in Beta (Purchase price \$1,000,000)	\$1,100,000
Proceeds from the sale of shares in Alpha (Purchase price \$850,000)	\$650,000
Proceeds from licensing of patents for the manufacture of motor vehicle engines. (A flat fee of \$58,000 per year)	\$58,000
Refund of company tax	\$100,000
Total receipts	\$4,000,000

Outgoings:

Operating expenses (eg. salaries and rent)	\$2,000,000
Interest free loan to assist employees made redundant due to economic downturn	\$70,000
Payment of fully franked dividend to shareholders	\$14,000
Total outgoings	\$2,084,000

The directors of Kars request that you:

- (a) Calculate the taxable income of Kars for the year of income ended 30 June 2003;**
- (b) Calculate the tax payable on the taxable income; and**
- (c) Advise as to the entries (if any) to the franking account of Kars.**

(For the purposes of the question use the corporate tax rate of 30%)

(25 marks)

(Question 5 follows)

Question 5

Part A

Beryl is a solicitor who on 1 July 2007 decides to commence practice from her home. She sets aside a room of her home as an office from which to conduct her business and meet clients. Beryl has earned a reasonable amount of income but has incurred the following expenditure during the year of income ended 30 June 2008:

- (a) Interest of \$10,000 paid to Big Bank Ltd in respect of a loan to purchase the house;
- (b) Electricity expenses of \$400 and gas expenses of \$250. The office has electric lighting and a gas heater, as do other rooms in the house;
- (c) Petrol expenses of \$1,000. Beryl owns a car and, apart from using it for private purposes, frequently has to drive from her home to various clients' offices to meet with and advise them, to law courts where she is appearing and also to other solicitors offices to do settlements on conveyancing matters;
- (d) Fees of \$900 paid to her Japanese language instructor, Ms Matsui. Beryl has three Japanese clients and feels that she may be able to expand her Japanese clientele if she is able to speak Japanese proficiently;
- (e) Amounts of \$3,000 paid to acquire a facsimile machine and \$400 to acquire paper from time to time for use in the machine;
- (f) Wages of \$25,000 paid to her secretary, Jacki. Jacki's duties include typing correspondence and legal documents, sending facsimiles and taking telephone messages. Beryl has a young son and Jacki is also required to look after him if Beryl is away from the office on business.

Advise Beryl on the deductibility of the above expenditure.

(15 marks)

Part B

What were the facts and issues decided by the High Court in *McCauley v FCT* (1944) 69 CLR 235 and *Stanton v FCT* (1955) 92 CLR 235? In particular in your answer you should state the reasons why the High Court held that the receipt was assessable to the taxpayer in *McCauley's* case but not in *Stanton's* case.

If the facts in *McCauley v FCT* arose today would the receipt be assessable under section 6-5 and/or section 15-20?

(10 marks)

(25 marks)

(Question 6 follows)

Question 6

Part A

John carries on a business selling and repairing television receivers in shop premises in Burwood. He also services television sets sold by him with a 12 month warranty for parts and labour. His practice is to allow a portion of the price for the sale of televisions to be retained by the buyer until 90 days after delivery to be sure that the goods are satisfactory.

On 1 December 2007 he sold his business to Smith, retaining only the book debts and a quantity of spare parts. He now carries on business as a repairer of television receivers, his place of business being a workshop at his home and since 1 December 2007 has returned his income on a cash basis.

Advise John as to the following matters:

- (a) **Whether the Commissioner would be obliged to accept a change to a cash basis of John's returns in respect of income of the repair business carried on after 1 December 2007;**
- (b) **Any implications that may follow from a conclusion that accruals basis of recognising income was appropriate to the business prior to 1 December 2007 and the cash basis appropriate thereafter;**
- (c) **The steps John should take to obtain a tax deduction in respect of the book debts retained by John on the sale of the business that he decides towards the end of June 2008 are unlikely to be recoverable.**

(15 marks)

Part B

Explain the conditions that must be satisfied in order for a company to claim as a deduction tax loss from previous years of income. In your answer you should refer to the applicable provisions of the Income Tax Assessment Act 1997 and the conditions prescribed by those provisions that must be satisfied.

(10 marks)

(25 marks)

END OF PAPER