

LEGAL PROFESSION ADMISSION BOARD

SEPTEMBER 2008

TAXATION AND REVENUE LAW

TIME: Three Hours.

The 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 examination. Candidates may refer to any books and any printed or handwritten materials 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.

Part A

It is often difficult to distinguish between events that give rise to assessable income and events that give rise to non-assessable gifts and prizes. Examples of where this difficulty arises are as follows:

- Gold medals won at the Olympic Games;
- Persons who have some event of notoriety arise in their life and receive large lump sum payments from the media for exclusive stories;
- Money paid to celebrities to ensure that they will appear on quiz shows;
- A legacy received by a professional man from a client many years after rendering services to him;
- A person providing assistance to a neighbour and being given a dozen bottles of wine for his assistance.

Analyse critically the distinguishing features of assessable income under the Income Tax Assessment Act 1997 as compared to non-assessable income, gifts and prizes. In your answer you should make reference to and comment on each of the above examples.

(15 marks)

Part B

Outline the facts and issues considered by the High Court in *C of T (SA) v Executor Trustee (Carden's Case)* (1938) 63 CLR 108 and the decision of the High Court in that case.

(10 marks)

(Question 2 follows)

Question 2.

Part A

Taxpayer is the owner of two rental properties. The first property was acquired by the Taxpayer in July 1985. On 1 January 2000, Taxpayer assigned his right to receive rent payable in respect of the property to his wife for nominal consideration for a period of eight years. At the time of the assignment, the property was subject to a ten year lease expiring after the end of the period of the assignment.

The second property (a home unit) was acquired on 1 January 2000. The property has harbour views and cost \$350,000 with the Taxpayer also paying \$10,000 in stamp duty and \$1,800 in legal fees at the time of acquisition of the unit. Before renting the property, the Taxpayer paid \$3,000 for it to be painted throughout and \$8,000 for a new kitchen to be installed. The Taxpayer also had the carpet steam cleaned for \$1,000 before renting the property. Each year the Taxpayer paid the body corporate levies on the unit which in total (up to time of sale) amount to \$6,000.

In January 2001 a proposal was before the local council for development of the adjoining property. If the development proceeded, the Taxpayer's second unit would lose its harbour views (and thereby significantly decreasing its market value). The Taxpayer spent \$16,000 in legal fees in successfully objecting to the development application. On 1 October 2005, the Taxpayer sold the unit for \$500,000 with the Taxpayer paying \$2,400 in real estate agent fees and \$2,500 in legal fees in relation to the sale.

Advise the Taxpayer on the tax consequences of the above facts. What if the second property was sold for \$300,000?

(15 marks)

Part B

Taxpayer was awarded \$40,000 by the Equal Opportunity Tribunal as compensation for discrimination experienced by the Taxpayer in her employment. The discrimination eventually forced the Taxpayer to resign and she has been unable to find other employment. The purpose of the compensation under the relevant legislation was to compensate the recipient for the pain and suffering resulting from incidents of discrimination and, in calculating the amount of the compensation, the Tribunal may take into account (and did take into account) lost earnings resulting from the discrimination.

Advise the Taxpayer of the tax consequences relating to the \$40,000 awarded. What would be the tax consequences if the Taxpayer settled the matter for \$40,000 before the Equal Opportunity Tribunal proceedings commenced?

(10 marks)

(Question 3 follows)

Question 3.

Part A

Quickkill Pty Ltd carries on the business of pest control. It provides the initial pest inspection free of charge. If there is an infestation of termites it notifies the owner who has to decide if he is prepared to pay Quickkill to deal with the infestation.

Where the owner hires Quickkill to deal with the infestation of termites, Quickkill chemically treats the area of the infestation, and then after 90 days inspects the infected area. If the initial application has not been successful in completely eradicating the termites, a further chemical treatment is applied to the infested area. Quickkill's experience is that a further chemical treatment is only necessary in 10% of cases.

Quickkill's standard fee for treating termites is \$200 which includes the initial chemical application, the inspection after 90 days, and the further chemical treatment (if necessary). In Quickkill's accounts, the \$200 is treated as being two thirds for the initial chemical application and the balance as a prepayment for future services to be provided (being the inspection after 90 days and the further chemical treatment, if necessary).

At the end of the 2006/2007 year of income, Quickkill has \$25,000 in its accounts which it has treated as prepayments for services rendered in respect of the initial chemical treatments performed in that year.

Quickkill seeks tax advice as to how to account for the \$25,000 for tax purposes. It also seeks advice on the costs associated with providing the initial pest inspections free of charge to potential customers.

(15 marks)

Part B

"Prior to capital gains tax being introduced there was a tendency by the courts to extend the concept of 'business proceeds' to those dealings which had the nature of income."

Comment on the above statement by explaining the approach the courts took in extending this concept. Any relevant statutory income provisions should also be referred to in your answer.

(10 marks)

(Question 4 follows)

Question 4.

Part A

Linda Brown, who is a secretary in a law firm, is preparing her tax return for the year of income ended 30 June 2008 from the following information relating to events that took place during the year of income (all purchases were made post September 1985):

- (1) Linda's gross salary for the year was \$40,000 from which her employer had deducted \$15,000 in pay as you go (PAYG) instalment withholding tax;
- (2) A bonus was given at Christmas to all secretaries in the form of a bottle of perfume with a value of \$200;
- (3) A colleague at work who is a close friend of Linda gave Linda a bottle of champagne that she had purchased for \$100 as a Christmas present;
- (4) Alpha Pty Ltd paid Linda a dividend of \$240 and the accompanying shareholder statement stated that the dividend was franked to 50%;
- (5) The sale of a work of art for \$500 which she had originally purchased for \$9000;
- (6) The sale of a rare antique for \$5,000 that she had originally purchased for \$50;
- (7) The sale her motor vehicle for \$5000 that she had originally purchased for \$15,000;
- (8) The sale of a sailing boat for \$10,000 that she had originally purchased for \$5,000 for her personal use;
- (9) A distribution of \$2,000 from a discretionary family trust;
- (10) A gift of a work of art valued at \$2,000 to her brother, that was originally purchased by Linda for \$1,000;
- (11) Interest expense of \$2,000 on a loan of \$20,000 to purchase the shares in Alpha;
- (12) Interest expense of \$500 on a loan taken out to pay her tax assessment for the previous year of income.

Advise Linda as to the tax implications in respect of each of the above events and calculate the amount of tax payable by Linda. (You may assume that Linda has a tax rate of 50% and the company tax rate is 40%).

(15 marks)

(Question 4 Part B follows)

Part B

By reference to income tax, capital gains tax and the goods and services tax (GST) explain:

- 1) the difference between a progressive tax versus a regressive tax;**
- 2) the difference between a direct tax versus an indirect tax; and**
- 3) what is meant by a wealth tax, and whether Australia has a wealth tax.**

(10 marks)

Question 5.

Part A

In July 2006 John Smith created a trust the terms of which provided that the trust income was divisible between his wife Mary and 14 year old daughter Ruth. Ruth is seriously mentally handicapped.

The family accountant David was appointed the trustee of the trust. During the year of income ended 30 June 2007 the trust income consisted of interest income of \$105,000. The cost of establishing the trust estate was \$5,000 and the yearly costs (accountancy fees etc) of maintaining the trust was \$3,000.

Advise John Smith, Mary, Ruth and David of the taxation implications of the above facts for the year ended 30 June 2007.

(15 marks)

Part B

On 31 December 2007 Alpha Pty Limited purchased a machine for use in its factory for \$100,000. The machine had an effective life of 5 years for income tax purposes and the company claims the capital allowance using the diminishing value method. The machine is sold on 30 June 2008.

Explain the tax consequences (including any capital gains tax consequences) of the sale where the sale price is alternatively:

- 1) \$70,000;**
- 2) \$95,000; and**
- 3) \$110,000**

(10 marks)

(Question 6 follows)

Question 6.

Part A

On 1 July 2005 George Smith borrows \$100,000 from Big Bank Limited. The annual interest rate is 12% per annum (being \$12,000 per year). George then lends this amount to Smith Pty Limited at an interest rate of 2% per annum (being \$2,000 per year). Smith Pty Limited is a company owned and controlled by George Smith and his wife.

The funds lent to Smith Pty Limited are used exclusively by the company to purchase a house that it rents to George for \$40 per week. The rent is set at an amount to allow the company sufficient funds to pay the 2% interest per annum to George. George declares as income the interest payments he has received from Smith Pty Limited and claims deductions for the amount of interest he has paid to Big Bank Limited and the rent that he paid to Smith Pty Limited.

In July 2007 George receives a notice of assessment from the Taxation Office which indicates that his deductions have been wholly disallowed.

Advise as to the following matters:

- a) **What advantage is George seeking to obtain by structuring his affairs in the above-mentioned matter?;**
- b) **If George does not accept the notice of assessment what avenues of appeal does he have and what time limits must he meet in pursuing his rights of appeal?;**
- c) **What are the prospects of success if George should appeal? Your answer should include reference to the possible application of Part IVA of the *Income Tax Assessment Act 1936*.**

(15 marks)

Part B

Explain the circumstances in which royalties at common law may be subject to income tax and why there is a definition of “royalties” in the Income Tax Assessment Act 1997.

(10 marks)

- END OF PAPER -