

LEGAL PROFESSION ADMISSION BOARD

MARCH 2013

TAXATION AND REVENUE LAW

Time: Three Hours This paper consists of **five** 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 and could, in some circumstances, result in the candidate receiving a fail grade.

This examination is worth 80% of the total marks in this subject.

Permitted Materials: This is an open book examination. Candidates may refer to any books and any printed or handwritten material they have brought into the examination room.

As some instances of cheating, plagiarism and of bringing unauthorised material into the examination room have come to the attention of the Admission Board, candidates are warned that such conduct may 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

- (a) Consider the following factual circumstances concerning John Smith:
- (i) John Smith embezzled \$10,000 from his employer Kids Toys Pty Ltd (a toy manufacturer) (“Kids Toys”) and placed the money on deposit in the bank;
 - (ii) Every year since the money was embezzled John Smith has earned interest on the deposit of \$10,000 in the bank;
 - (iii) John Smith leaves his employer, Kids Toys, to establish his own business and in return for a payment of \$50,000 from Kids Toys enters into an agreement with his former employer not to work with a competitor for 12 months;
 - (iv) When John Smith leaves Kids Toys, his former employer in recognition of his long service to the company, allows him to take his office chair and desk with him (which had been supplied and owned by Kids Toys);
 - (v) The new business being established by John Smith is as a wholesale distributor of children’s toys. His new business may involve purchasing toys from his former employer Kids Toys from time to time. To encourage John Smith to acquire the toys from his former employer, Kids Toys provides him with the free use of some of its office space for the next 12 months.

In relation to each of the abovementioned factual circumstances advise John Smith and Kids Toys of the taxation implications.

(15 marks)

- (b) **Outline the facts and issues that arose in *Commissioner of Taxation (SA) v Executor Trustee (Carden’s Case)* (1938) 63 CLR 108. What new provision was introduced into the *Income Tax Assessment Act 1936* as a consequence of the *Carden’s* case, and how did the new provision operate?**

(5 marks)

(Question 2 follows)

Question 2

(a) Derek plays the trombone in a Sydney nightclub owned by Beverly. The arrangement is that Beverly pays Derek \$30 per night for a 3 months season (equating to 90 nights) and he is allowed to consume as much of the nightclub's liquor as he wishes when he is working.

Unfortunately Derek can drink prodigious amounts of alcohol and on the first night Beverly became so annoyed at Derek's drunken behaviour that she threw a glass at him which hit him in the mouth and knocked out his front teeth.

Derek, naturally, ceases to work for Beverly after this episode and sues her in respect of the personal injury he has suffered. Beverly agrees to pay Derek compensation of \$2,700 for his injury based on what he would have earned if he had worked for the 90 nights.

Derek secures new employment in a nightclub owned by Anna but finds it most difficult to play the trombone with his front teeth missing. He visits Claude, a dentist, who provides Derek with artificial front teeth. The new teeth enable Derek to play the trombone so well that he is given a pay rise by Anna. Derek pays Claude \$2,000 for the dental services provided.

Advise Derek and Beverly generally as to the tax implications.

(15 marks)

(b) Outline the tests that must be satisfied by a company in order for a company to be able to claim a deduction for tax losses of previous years.

(5 marks)

(Question 3 follows)

Question 3

(a) On 1 July 2010, Alpha Pty Ltd ("Alpha") purchased a machine partly for use in a factory for \$10,000. The machine was used 50% of the time in the factory for business use, and 50% of the time for private purposes. Under the Commissioner's written determination the machine had an effective life of 5 years.

The machine was sold on 31 December 2011. During the period that the machine was owned by Alpha, Alpha claimed the capital allowance using the diminishing value method.

Calculate the capital allowance claimed by Alpha up to 31 December 2011. In addition explain the tax consequences of the sale of the machine where the sale price is alternatively:

- (i) \$4000;**
- (ii) \$6000; and**
- (iii) \$11,000.**

(15 marks)

(b) The disposal of an asset on or after 19 September 1985 may give rise to a capital gain even when the asset was acquired prior to 19 September 1985.

Refer to the provisions that give rise to this result and explain how those provisions operate. Further explain the rationale underlying the need for the provisions.

(5 marks)

(Question 4 follows)

Question 4

(a) Civic Pty Ltd (“Civic”) maintains a franking account so as to enable it to determine its ability to pay franked dividends. For the year ended 30 June 2012 the following events took place:

- (i) Civic receives a dividend of \$28,000 from another company that is franked to 50%;
- (ii) Civic pays a dividend to Jack of \$4,200 franked to 50%;
- (iii) Civic pays four tax instalments to the Australian Taxation Office (“ATO”) each of \$21,000;
- (iv) Civic receives an unfranked dividend of \$3,000 from another company;
- (v) On the resolution of a dispute with the ATO, the ATO refunds \$3,000 of tax previously paid by Civic.

Advise Civic as to the effect (if any) on its franking account in respect of the above events. Also advise Jack of the tax consequences to him of being paid a dividend of \$4,200 franked to 50%. (You may assume a company tax rate of 30% and an individual tax rate of 50%).

(15 marks)

(b) Explain by reference to the relevant statutory provisions and case law whether “initial” repairs (i.e., repairs to defects existing at the time an item is purchased by a taxpayer) are deductible.

(5 marks)

(Question 5 follows)

Question 5

(a) Mary Smith, who is a secretary in an accountancy firm, is preparing her tax return for the year of income ended 30 June 2012 from the following information relating to events that took place during the year of income (all purchases were made post September 1985):

- (1) Mary's gross salary for the year was \$80,000 from which her employer had deducted \$20,000 in pay as you go (PAYG) instalment withholding tax;
- (2) All secretaries in the firm were given a Christmas hamper with a value of \$500;
- (3) A colleague at work who is a close friend of Mary, gave Mary a bottle of perfume that she had purchased for \$50 as a Christmas present;
- (4) The sale of a work of art for \$4,000 which she had originally purchased in December 1999 for its then market value of \$400;
- (5) The sale of a rare antique for \$5,000 that she had inherited from her deceased mother – the mother had purchased the antique for \$500;
- (6) The sale her motor vehicle for \$5000 that she had originally purchased for \$10,000;
- (7) The sale of her sailing boat for \$12,000 which she had purchased for \$8,000 for casual sailing on the weekends;
- (8) Payments of \$100 that she makes to her mother each week to look after her 4 year old child so that she can go to work;
- (9) A distribution of \$1,000 from a discretionary family trust;
- (10) A gift of a work of art valued at \$8,000 to her brother for his wedding, that was originally purchased by Mary 5 years earlier for \$1,000 and kept as part of her personal collection;
- (11) Part-repayment of \$5,000 on a loan of \$50,000 used to purchase shares in public companies listed on the Australian Stock Exchange;
- (12) Interest expense of \$500 on a loan taken out to pay her tax assessment for the previous year of income.

Advise Mary as to the tax implications in respect of each of the above events.

(15 marks)

(b) When will an individual (not a company) be a foreign resident for the purposes of the *Income Tax Assessment Act 1997*?

(5 marks)

END OF PAPER