LEGAL PROFESSION ADMISSION BOARD

SEPTEMBER 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

For a number of years Ava Cosmetics Pty Ltd ("Ava") was in the business manufacturing and distributing cosmetics for women. A separate division of its business also consisted of the distribution of exclusive clothes for women. The exclusive clothes business was the subject of stock being stolen and a number of employees from the division had their employment terminated in June 2008. An industrial dispute ensued with the former employees over their termination, which was not resolved until January 2009 when Ava agreed to make modest payments of $10,000 to each employee who had been terminated.

Karen was an employee in the cosmetic division and retained her job in the accounts department. As part of her remuneration package Karen was provided with free cosmetics and Ava reimbursed her for the costs of her child, David, being placed in a day care centre run by her local council.

Ava sold cosmetics by wholesale to a number of retailers who exclusively sold Ava products and seemed to be doing particularly well. Accordingly Karen resigned from Ava to commence her own business as a retailer selling Ava products.

At the time of her termination of employment Ava provided Karen with an interest free loan of $50,000 to help her establish her business. It was common for Ava to provide such assistance to independent businesses being established to sell its products. As part of the arrangements Ava also paid Karen $10,000 for her entering into an agreement to only sell Ava products for the next 2 years.

Karen sold so many Ava products in the first year that she won a holiday from Ava for selling more Ava products than any other retailer. The prize was a free holiday to Bali. The holiday was non-transferable and the airline company would not allow her to "cash in" the ticket. However, as Karen had already been to Bali recently, she decided not to take the holiday.

Advise Ava, Karen and the terminated employees of the tax implications of the above facts.

(20 marks)

(Question 2 follows)

Question 2

Mechanics Limited ("Mechanics") is a public company engaged in the manufacture and sale of motor vehicles. Mechanics also owns shares in two companies called Ipa Limited ("Ipa") and Costa Limited ("Costa") which were acquired by Mechanics in 2006. For the year ended 30 June 2012 Mechanics has the following receipts and outgoings:

Receipts:

Sales revenue	$5,000,000
Fully franked dividend from Ipa	$21,000
Partially franked dividend from Costa [Franked to 50%]	$42,000
Proceeds from the sale of shares in Ipa [Purchase price $1,000,000]	$800,000
Proceeds from the sale of shares in Costa [Purchase price $250,000]	$650,000
Proceeds from the sale of the building containing the head office of Mechanics [Purchase price $2,000,000]	$1,000,000
Interest paid on term deposits held with the bank	$19,000
Refund of company tax for the 2011 income year	$100,000
Total receipts	**$7,632,000**

Outgoings:

Operating expenses (e.g. salaries)	$3,000,000
Redundancy payments to employees	$20,000
Payment of fully franked dividend to shareholders	$21,000
Total of instalment payments of company tax for the 2012 income year	$400,000
Lease payments on machinery	$70,000
Staff training	$10,000
Total outgoings	**$3,521,000**

The directors of Mechanics request that you:

(a) Calculate the taxable income of Mechanics for the year of income ended 30 June 2012;

(b) Calculate the tax payable on the taxable income; and

(c) Advise as to the entries to the franking account of Mechanics.

[For the purposes of the question use the corporate tax rate of 30%.]

(20 marks)

(Question 3 follows)

Question 3

(a) On 1 July 2010, Alpha Pty Ltd ("Alpha") purchased a machine partly for use in factory for $100,000. 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 10 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 prime cost 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) $80,000;

(ii) $90,000; and

(iii) $105,000.

(15 marks)

(b) When will a company be a foreign resident for the purposes of the *Income Tax Assessment Act 1997*?

(5 marks)

Question 4

In 1984, a number of people with weekenders at Stony Retreat on the North Coast of New South Wales formed a company, Coast Pty Ltd ("Coast") to buy and hold a strip of beachfront land between their weekenders and the beach. Their intention and that of Coast when it acquired the beachfront was to hold it unspoiled to protect their access to the beach and the environment. The land remained untouched until January 2009 when the whole of the issued capital of Coast was acquired by Developers Pty Ltd ("Developers"), and directors of Developers were appointed to the board of directors of Coast.

In the tax year ended 30 June 2009 Coast granted a saw miller the right to cut and remove the timber on the beachfront land. The saw miller was required to pay $1,000 to Coast for each tree cut and removed.

In the tax year ended 30 June 2010 Coast has the beachfront land sub-divided into 30 lots and roads, gutters, water, sewers and electricity installed. It then sells the subdivided lots individually after a substantial advertising campaign in Sydney and Melbourne.

In respect of each of the years of income ended 30 June 2009 and 2010 advise Coast as to the following:

(i) The tax implications <u>ignoring</u> capital gains tax;

(ii) The tax implications taking into account capital gains tax.

(20 marks)

(Question 5 follows)

Question 5

(a) 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 2006 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 ("Fido Pty Ltd") 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 2008. 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 2006 but still continued to publish the "World Affairs".

From February 2006 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:

- **(i)** **The deductibility to World Publications of the legal expenses connected with the defamation litigation;**
- **(ii)** **The deductibility to World Publications of the judgment of $40,000;**
- **(iii)** **Whether Fido Pty Ltd was assessable in respect of the judgment of $40,000;**
- **(iv)** **Would your answer to (iii) be any different if World Publications and Fido Pty Ltd had settled the claim out of court for a payment of $40,000 to Fido Pty Ltd in consideration of Fido Pty Ltd giving World Publications a general release in respect of any claims it may have against World Publications;**
- **(v)** **The deductibility to World Publications of the salary paid to Smith for the period from February 2006 to February 2008;**
- **(vi)** **The deductibility to World Publications of the office expenses that related to Smith's activities for the period from February 2006 to February 2008;**
- **(vii)** **The deductibility to World Publications of the purchase price paid for "Cuddly Animals".**

(15 marks)

(b) **What were the facts and circumstances that arose in *Taylor v FCT* (1969) 119 CLR 444?**

(5 marks)

END OF PAPER