

Main exam

3 September 2019

**Time allowed – Three hours
(plus 15 minutes reading time)**

This open-book exam contains four (4) short-answer questions to a total of 80 marks

This paper contains 9 pages

Question 1 (20 marks)

Note: All amounts are in Australian dollars. Ignore GST.

Harry and George are Australian resident individuals and equal partners in the Kingsley Accounting Partnership (KAP). KAP carries on an accounting services business. KAP's net partnership income is allocated to the partners equally after entitlements to partner salaries. For income tax purposes, KAP is not a small business entity or a medium-sized business.

KAP's income statement and notes for the income year ended 30 June 2019 are as follows:

Kingsley Accounting Partnership			
Income statement as at 30 June 2019 and notes			
Item		\$	Notes
	Income		
1	Professional services income	5,000,000	Accounting services income which has been invoiced to clients. It includes invoices totalling \$220,000 which were issued during the income year ended 30 June 2019 and remain outstanding at 30 June 2019. It excludes invoices totalling \$100,000 which were issued in the income year ended 30 June 2018 and received during the income year ended 30 June 2019
2	Work in progress	550,000	Work to date for clients which could not be invoiced as at 30 June 2019 because the engagements had not been completed
3	Distribution from a property unit trust	2,000	KAP holds a 10% interest in a property unit trust that has trust income (i.e. accounting profit) of \$20,000. For tax purposes, the trust made a tax loss of \$10,000 due to differences in the timing of when amounts are deductible. On 1 July 2018, KAP's cost base in the trust was \$45,000
4	Interest income	10,000	On 1 March 2019, KAP deposited money into a three-month term deposit. On 1 June 2019, the principal, along with \$10,000 of interest income accrued, was reinvested into a further three-month term deposit which matured on 1 September 2019
5	Gain on sale of vacant land	40,000	The land was acquired as a long-term investment in 2007 for \$300,000 and sold in June 2019 for \$490,000. At the time of sale, the land had a carrying value on KAP's balance sheet for accounting purposes of \$450,000. There have been no adjustments to the cost base for tax purposes
6	Lease incentive	100,000	KAP received a rent-free period worth \$100,000 as an incentive for signing a lease for new office premises
	Expenses		
7	Salary	(650,000)	Includes salaries of \$200,000 paid to the partners (\$120,000 to Harry and \$80,000 to George). Harry and George do not draw any benefits outside of partner salaries
8	Employee benefit expenses	(100,000)	Includes accrued employee entitlements of \$35,000 for annual leave that has not yet been taken by employees. There was no accrued annual leave at the end of the prior income year
9	Provision for employee bonus	(84,000)	Estimate of bonuses to be paid to employees in August 2019, which is subject to the partners' discretion as part of the employee salary reviews

Question 1 continues, please turn over

Question 1 (cont.)

Kingsley Accounting Partnership			
Income statement as at 30 June 2019 and notes			
Item		\$	Notes
10	Interest expense	(30,000)	Interest paid on a \$400,000 loan borrowed from the bank. The loan was taken out during the income year ended 30 June 2019 and used to refinance \$400,000 of capital that Harry and George withdrew from the partnership. The capital withdrawn was: <ul style="list-style-type: none"> • Distributed equally to Harry and George. The partners used their distributions to acquire various investments generating assessable income • Debited to 'Partner capital accounts' in the amount of \$320,000 and 'Business revaluation – Goodwill' in the amount of \$80,000. Both Harry and George's partner capital accounts remain in credit after this distribution
11	Prepaid professional indemnity insurance	(90,000)	KAP prepaid six months of professional indemnity insurance on 30 June 2019 for the period 1 July 2019 to 31 December 2019
12	Professional costs	(15,000)	Legal and accounting expenditure incurred in seeking advice, unrelated to tax, to convert the partnership to a company structure in order to limit professional liability
13	Entertainment expense	(52,000)	Costs incurred by Harry and George to entertain clients at various restaurants. Of the total cost, 40% relates to Harry and George and 60% relates to clients. KAP uses the actual expenditure method for fringe benefits tax purposes
14	Doubtful and bad debts expense	(50,000)	30% of this amount was written off as bad debts before 30 June 2019. All debts have previously been included in assessable income
	Accounting profit	<u>4,631,000</u>	

Assume that items 1 to 14 are the only items that may give rise to tax adjustments for KAP.

Required
<p>(a) Calculate KAP's net income for the income year ended 30 June 2019 by (17 marks) preparing a reconciliation from accounting profit to net income, and calculating the correct tax adjustments (including nil adjustments) in respect of items 1–14. Provide a case reference to support item 7, an explanation for item 10, and the most relevant section reference for the other items. Show all workings.</p> <p>(b) Calculate Harry's taxable income for the income year ended 30 June 2019. (3 marks) Assume Harry has no other income.</p> <p>Ignore the taxation of financial arrangements (TOFA) provisions.</p>
<u>20 marks</u>

End of Question 1
Exam paper continues, please turn over

Question 2 (20 marks)

Part A (13 marks)

Note: All amounts are in Australian dollars and are GST-inclusive where applicable.

ABC Pty Limited (ABC) is an architecture practice based in Sydney. Susan holds 100% of the shares in ABC and has never been an employee of ABC. Jenny is the managing director of ABC.

During the fringe benefits tax (FBT) year ended 31 March 2019, ABC provided the following benefits:

1. ABC reimbursed Kevin (an employee) and James (a contractor who provided an ABN and is engaged for a major project) for computer software which they purchased and used solely for working on ABC client projects. The cost of the software was \$1,000 to each worker.
2. In 2017, ABC provided its chief financial officer and his wife (not an employee of ABC), with an interest-free loan of \$20,000. The couple used the loan to pay for repairs to their jointly held rental property. The \$20,000 loan remains outstanding at the end of the FBT year. The property was rented at market rates for the full year.
3. Susan and Jenny went on a holiday together to Queensland. ABC paid for their business class flights, which cost \$2,200 each. Susan did not reimburse the company for the expense; however, Jenny paid 50% of the cost from her after-tax salary.
4. In December 2018, ABC paid for a Christmas lunch that Jenny hosted at her favourite restaurant. In addition to Jenny, there were five clients in attendance. The total cost of the lunch was \$1,500.

ABC had a distributable surplus of \$1 million at 30 June 2019. It uses the 50/50 split method for calculating meal entertainment benefits.

ABC is registered for GST and where relevant has the necessary tax invoices. All relevant private use declarations have been provided by employees to ABC.

Required	
(a) Calculate the total FBT payable by ABC for the FBT year ended 31 March 2019. Briefly explain any nil amounts. Show all workings.	(8 marks)
(b) For items 3 and 4 above, briefly explain the:	(5 marks)
(i) Income tax considerations for ABC for the income year ended 30 June 2019.	
(ii) GST consequences for ABC.	
	<u>13 marks</u>

Question 2 continues, please turn over

Question 2 (cont.)

Part B (7 marks)

Note: All amounts are in Australian dollars. Ignore GST.

Pet Pty Limited (Pet) is an Australian resident company that has been 100% owned by Joe, an Australian resident for tax purposes, since the company was established in 1992.

On 1 July 2018, Joe sold all his shares in Pet to Martha. No changes have been made to the business since it was bought by Martha. During the income year ended 30 June 2019, Pet received the following:

- Trading income of \$15,000.
- A \$40,000 dividend from a large mining company, Park Limited (Park), franked to 100%. Park has a corporate tax rate of 30% for imputation purposes. Pet has received dividends from its shareholding in Park since 1992.

Pet has no other assessable income or expenses for the income year ended 30 June 2019.

Pet is a base rate entity and has a carry forward tax loss of \$60,000.

Required

- (a) Explain whether Pet can use the carry forward tax loss in the income year ended 30 June 2019. (Note: You do not need to provide calculations). (2 marks)
- (b) Ignoring your conclusion in (a) above, assume that the carry forward tax loss is available to be recouped during the income year ended 30 June 2019. Calculate Pet's minimum tax payable for the income year ended 30 June 2019. Show all workings. (5 marks)

7 marks

End of Question 2
Exam paper continues, please turn over

Question 3 (20 marks)

Part A (11 marks)

Note: All amounts are in Australian dollars. Ignore GST.

Chin Chin, an Australian resident, migrated to Canada on 30 September 2018. He ceased to be an Australian resident on this date. The assets that he owned as at this date were as follows:

	Asset	Date of acquisition	Cost of acquisition	Market value as at 30 September 2018	Notes
1	Digital camera	23.04.2015	\$11,000	\$12,500	For personal use
2	Stamp collection	10.03.2016	\$350	\$2,000	
3	Rental property in the United Kingdom	30.09.2016	\$400,000	\$405,000	Division 43 ITAA 1997 capital works deductions in relation to this building is \$5,000 per year
4	Vacant land in Sydney	01.02.2017	\$350,000	\$351,000	
5	Electronic tablet	15.04.2017	\$1,099	\$400	For personal use
6	BHP shares	14.10.2017	\$12,000	\$20,000	Portfolio interest

Chin Chin has carry forward capital losses of \$7,000 and has not made any elections for income tax purposes.

Required

Identify the relevant capital gains tax (CGT) event. Calculate the minimum net capital gain or maximum capital loss for Chin Chin as a result of the CGT event. Show all workings. Provide a relevant section reference for any exclusions.

11 marks

Question 3 continues, please turn over

Question 3 (cont.)

Part B (5 marks)

Note: All amounts are in Australian dollars. Ignore GST.

Ethan is an individual who does not carry on a business. On 1 July 2017, he acquired a partially furnished residential rental property which was not new. Included in the property at the time of purchase were the following assets:

Asset	Cost	Useful life
Furniture	\$20,000	5 years

During the income year ended 30 June 2019, Ethan acquired the following brand-new assets for the rental property:

Date of acquisition	Asset	Cost	Useful life
01.07.2018	Table	\$299	5 years
01.07.2018	Rental property management software	\$1,500	3 years
01.06.2019	Microwave	\$600	4 years

Where possible, Ethan tries to align the effective life of his assets with their useful life.

Required

Calculate Ethan's maximum decline in value deduction (if any) for each asset for the income year ended 30 June 2019. Show all workings. Provide a relevant section reference for each asset.

5 marks

Part C (4 marks)

Note: All amounts are in Australian dollars. Ignore GST.

Alyssa Pty Limited (APL), a resident company and a small business entity (SBE) taxpayer, acquired the following assets for its business:

Date of acquisition	Asset	Cost	Effective life	Taxable use %
01.07.2018	Machine 1	\$27,000	5 years	100%
01.02.2019	Machine 2	\$35,000	10 years	80%
01.06.2019	Car	\$29,990	8 years	100%

APL wishes to maximise its deduction for the income year ended 30 June 2019. It has chosen to apply the SBE capital allowance rules.

Required

Calculate APL's total deduction for decline in value for the income year ended 30 June 2019. Show all workings. Provide a relevant section reference for each asset.

4 marks

End of Question 3
Exam paper continues, please turn over

Question 4 (20 marks)

Part A (17 marks)

Note: All amounts are in Australian dollars except where otherwise indicated. Ignore GST.

Professor Hawk is an Australian resident. For the income year ended 30 June 2019, Professor Hawk provided the following information:

- On 1 December 2018, he received foreign dividends of \$5,000 paid out of previously attributed controlled foreign company income. No foreign tax was imposed on the dividends.
- On 1 February 2019, he received net interest income of \$9,000 from a foreign source. Foreign withholding tax of \$1,000 was imposed on the interest.
- On 2 April 2019, he sold land situated in Fairyland (a non-treaty country) for Fairy dollars (F\$)50,000. The land had been acquired on 1 April 2017 for long-term investment purposes for F\$31,250.

The sales proceeds were repatriated to Professor Hawk on 5 June 2019. Professor Hawk has elected under Division 775 ITAA 1997 to opt out of the short-term forex rules.

Fairyland's capital gains tax on the sale was F\$10,000 and was paid on 5 June 2019.

The relevant foreign exchange rates were as follows:

Date	Exchange rate
1 April 2017	F\$1.00 = AUD 1.60
2 April 2019	F\$1.00 = AUD 1.80
5 June 2019	F\$1.00 = AUD 1.90

- He earned other income with an Australian source of \$90,000.

Professor Hawk has Australian private health insurance. Assume Professor Hawk is not entitled to the low or middle income tax offset.

Required

Calculate Professor Hawk's minimum tax payable for the income year ended 30 June 2019. Briefly explain any exclusions. Show all workings.

17 marks

Part B (3 marks)

Note: All amounts are in Australian dollars.

Ronan is an Australian resident individual. On 1 July 2018, he borrowed funds from an Australian bank to purchase 15% of the shares in a foreign company. On 30 June 2019, the foreign company credited a \$10,000 dividend to Ronan, which he received on 2 July 2019. Ronan incurred \$3,000 of interest expenses on the loan.

Required

Explain Ronan's key income tax consequences for the income year ended 30 June 2019 and provide relevant section references.

3 marks

End of Question 4

End of exam

Appendix

Income tax rates 2018–19 – Resident individual		
Taxable income	Tax rate*	Tax
\$	%	
0–18,200	0	\$nil
18,201–37,000	19	19c for each \$1 over \$18,200
37,000–90,000	32.5	\$3,572 plus 32.5c for each \$1 over \$37,000
90,000–180,000	37	\$20,797 plus 37c for each \$1 over \$90,000
180,001 and over	45	\$54,097 plus 45c for each \$1 over \$180,000

* The above rates do not include the Medicare levy of 2% or the Medicare levy surcharge.