TAXATION OF BUSINESS ENTITIES  LEGT 5582

1. COURSE STAFF

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1.1 Communication with Staff

John Taylor will usually be available for consultation on Mondays from 2 pm to 3pm and otherwise by appointment. Communication by e-mail is encouraged.

2. INFORMATION ABOUT THE COURSE

2.1 Teaching times and Locations

Classes will be held on Tuesday mornings from 11am to 2pm

2.2 Units of Credit

This course is worth 6 units of credit

2.3 Parallel teaching in the course

This course is taught in parallel with an undergraduate course LEGT 3755 Taxation of Business Entities. Different assessment tasks are set for graduate and undergraduate students.

2.4 Relationship of this course to other course offerings

This course is taught as part of the Master of Commerce degree and may be undertaken either as part of a Business Law specialisation or as an option in any other specialisation in the Master of Commerce degree. The course builds on knowledge and skills gained by students in their prior studies particularly in LEGT 5551 Taxation Law. The course examines the tax treatment of the common types of business entities in Australia and analyses that treatment in the light of widely accepted tax policy principles.

2.5 Approach to learning and teaching

The teaching philosophy underpinning the course aims to:

Promoting deep learning by:

- Discussing detailed technical provisions against the background of the issues and problems underpinning them, of alternative approaches to them and of basic tax policy objectives;

- Limiting the breadth of material dealt with in the course so the above issues are highlighted and significant structural features are examined;
• Involving you in the learning process through small group work, class discussions of case studies, and student presentations.

**Developing your skills by:**

• Requiring you to read and apply primary source materials in the context of practical case study examples;

• Requiring you to find, read and analyse major secondary works relevant to the background issues, problems, alternative approaches and policy underpinnings of relevant provisions in the income tax law;

• Requiring you to work in groups and to agree on the format of group presentations;

• Requiring you to make oral and media assisted presentations in class.

**Recognising the different learning styles of individuals by:**

• Using a variety of teaching approaches including: lecturer presentations; in class discussions of case studies; student explanations of problems; student presentations of papers; and small group discussions and presentations;

• Using a variety of types of assessment techniques including: responses to case studies; the writing and explanation of problems; small group discussions and presentations; and a final examination.

### 3. COURSE AIMS AND OUTCOMES

#### 3.1 Course Aims

This course aims to:

1. Compare and contrast the tax treatment of different types of business entities and their stakeholders in Australia;

2. Build on your existing knowledge base by identifying issues and problems and alternative approaches in relation to the tax treatment of different types of business entities and their stakeholders;

3. Enhance your expertise in reading and understanding primary source material relevant to the tax treatment of different types of business entities and their stakeholders;

4. Develop your skills in applying relevant primary source materials in the context of case studies involving the tax treatment of different types of business entities and their stakeholders;

5. Develop your abilities in researching issues relating to the tax treatment of different types of business entities and their stakeholders through the use of secondary source material;
6. Give you more experience in working in teams in researching and delivering a presentation;

7. Give you more experience in publicly presenting and defending a paper.

### 3.2 Student Learning Outcomes

After completing this course you should be able to:

- Identify key issues relevant to the taxation of business entities in a given fact situation
- Locate and use resources that will assist you in developing a response to issues arising in the taxation of business entities
- Explain your response to issues arising in the taxation of business entities through oral and written presentations
- Identify different outcomes that result when different tax planning strategies are used in relation to business entities
- Compare the Australian approach to selected business entity taxation design issues with that taken in other OECD countries

### 3.3 Teaching Strategies

The method of teaching in this course will take the form of presentation of papers by the lecturers, discussion of case studies, presentation of research papers by students in LEGT 5582, student explanations of problems written by students, and small group discussions and presentations of the results of those discussions.

### 4. STUDENT RESPONSIBILITIES AND CONDUCT

#### 4.1 Workload

It is expected that you will spend at least **ten hours** per week studying this course. This time should be made up of reading, research, working on exercises and problems, and attending classes. In periods where you need to complete assignments or prepare for examinations, the workload may be greater.

Over-commitment has been a cause of failure for many students. You should take the required workload into account when planning how to balance study with employment and other activities.

#### 4.2 Attendance

Your regular and punctual attendance at lectures and seminars is expected in this course. University regulations indicate that if students attend less than eighty percent of scheduled classes they may be refused final assessment.

#### 4.3 General Conduct and Behaviour

You are expected to conduct yourself with consideration and respect for the needs of your fellow students and teaching staff. Conduct which unduly disrupts or interferes with a class, such as ringing or talking on mobile phones, is not acceptable and students may be asked to leave the class. More information on student conduct is available at: [www.my.unsw.edu.au](http://www.my.unsw.edu.au)
4.4 Keeping informed

You should take note of all announcements made in lectures, tutorials or on the course web site. From time to time, the University will send important announcements to your university e-mail address without providing you with a paper copy. You will be deemed to have received this information.

5. Learning Assessment

5.1 Formal Requirements

To complete and pass the course a student is required to:

(i) attend a minimum of 80% of classes held in all parts of the course;

(ii) complete all the written assignments which have been allocated to that student by the lecturer;

(iii) actively participate in the small group case study;

(iv) obtain an overall mark which will entitle the student to the grade of pass in accordance with general university guidelines.

5.2 Assessment Details

Each student will be required to submit a 2000 to 2500 word research paper on an assigned topic. In addition to writing the paper each student will be required to present a synopsis of the paper to the class. The length of the presentation should not exceed 15 minutes. The student presentation of the paper will be taken into account in marking the paper. The combined mark for the paper and the presentation will be 30% of the total marks for the course. The paper should be typed and should be submitted in duplicate to the lecturer at least one week before the week in which the student’s presentation of the synopsis of the paper is due. Papers may be submitted to the lecturer as e-mail attachments. Copies of the synopsis of the student’s paper should be circulated to other students on the evening when the synopsis is presented.

A set of case studies will be discussed in class in seminars led by the lecturer. Each student will be required to write a response to one of these case studies. The responses should be typed and should be handed in to the lecturer at least one week before the case study is discussed in class. The case study responses should not be less than 1000 words. The case study response and the student’s response to questions in class about it from the lecturer and from peers will be worth 20% of the total marks for the course.

The end of session examination will be worth 30% of the total marks for the course. The end of session examination will contain both problem questions and theoretical questions. Further details about the examination will be provided later in the session.

Weeks Twelve to Fourteen will include small group discussion of parts of an inter-related case study. Groups will be required to record the results of their discussions and to present them to the class. Different persons from each group will be required to present the results of the group's discussion in each of the three weeks. Members of each group will be awarded a mark out of 20 for the quality of their discussions and the quality of their presentations.
The topics on which students may write research papers are listed in this course outline. Students may choose a topic which is not on the list provided the lecturer gives written approval of the student's choice of topic. Allocation of research paper topics to students will be done following consultation with students but the final decision on topic allocation will be the lecturer's decision. After topics have been allocated to students details of the weeks in which paper topics are to be dealt with will be notified to students.

**PAPER TOPICS**

1. The principle of horizontal equity requires that all business income be taxed comparably. To what extent does the Australian tax treatment of business income derived via different forms of entity achieve this objective? Consider in particular the derivation of tax preferred income, the treatment of new equity injections, and the treatment of losses.

2. Compare the Australian dividend imputation system with each of the following systems: (a) a dividend exemption system; (b) a system in which 50% of dividends paid is exempt; (c) a system in which dividends paid are taxed at a low flat rate for all shareholders; (d) a system in which corporate profits are taxed only at the shareholder level irrespective of actual distribution; and (d) a system in which dividends are deductible to companies. Evaluate each of these systems in terms of vertical and horizontal equity. Consider the treatment of both resident and non-resident shareholders and of domestic and foreign source income in each of these systems.

3. Compare the Australian tax effects of different forms of corporate distributions by resident companies. Your analysis should examine: (a) dividend distributions; (b) off market buy backs; (c) on market buy backs; (d) returns of capital with cancellation; (e) returns of capital without cancellation; and (f) liquidator’s distributions. Evaluate the current tax treatment of these forms of distribution in terms of horizontal equity. What reforms, if any, should be made in the Australian tax treatment of alternative forms of distribution.

4. When is a beneficiary absolutely entitled to a trust asset as against the trustee? What is the significance of concluding that a beneficiary is so entitled?

5. Discuss the tax effects of payments for work in progress on a change in the composition of a partnership. Does s25-95 satisfactorily resolve problems previously identified in this area?

**SMALL GROUP CASE STUDY ON COMPARATIVE ENTITIES**

In Year 1 John, Kev and Alexander take up a business opportunity, manufacturing lie detectors in Australia. John and Kev are resident sui juris individuals. Alexander is a resident of Iraq (a country with which Australia does not have a Double Tax Agreement). Each of them will make equal contributions of equity to the venture.

John, Kev and Alexander anticipate that, because of the high demand for lie detectors in Australia, their venture will produce substantial profits from its first year
of operation. Because of the availability of research and development incentives they also anticipate that the financial accounting profit from the venture will be higher than the taxable income derived from the venture.

John, Kev and Alexander’s plan is to grow the business over a six year period and to then make a substantial profit on its sale. In the interim, as the business will be their only source of income, they will require that 50% of its profits be distributed to them so they can maintain their lifestyles. Despite the anticipated growth of the business in the six year period John, Kev and Alexander expect that when the business is ultimately sold the net value of its assets will be below the maximum net asset threshold for purposes of the CGT small business concessions. After the sale of the business John, Kev and Alexander plan to migrate to Bali to spend the profits arising from the sale on riotous living.

John, Kev and Alexander seek your advice as to the comparative tax effects of undertaking their venture using the following structures:

- an Australian resident private company for tax purposes;
- a partnership;
- an Australian resident unit trust; and
- an Australian resident discretionary trust.

Where relevant in the case of each structure consider how profit distributions during the life of the venture and the ultimate profit made on the sale of the business can most effectively be distributed to them from a tax point of view.

How, if at all, would your advice differ if it were known that John planned to retire from the venture within six months of it commencing and planned to sell his interest in the venture to Peter (an Australian resident sui juris individual) at a substantial profit.

How, if at all, would your advice differ if Alexander were a resident of the United States of America?

DETAILS OF TASKS THAT WILL BE ASSIGNED IN RELATION TO THE SMALL GROUP CASE STUDY CAN BE FOUND UNDER WEEKS 12 TO 14 IN THIS COURSE OUTLINE AND ON THE COURSE WEBCT PAGE

**SUMMARY OF ASSESSMENT**

Paper and presentation 30%
Written response to case study 20%
Small group discussion and presentation 20%
End of session examination 30%

5.3 Assignment Submission Procedure

All assignments be submitted as e-mail attachments to John Taylor c.taylor@unsw.edu.au by 12 noon on the due date for the assignment. A hard copy of each assignment should also be handed in to John Taylor at the class in which the assignment is due.
5.4 Late Submission
Assignments submitted after the due date will not be accepted without penalty unless prior approval has been granted by the lecturer. Assignments that are submitted late without prior approval will have 10% of the available marks deducted and (where applicable) no mark for presentation will be awarded.

If you foresee that you will have problems submitting an assignment on time you should contact the Lecturer by e-mail immediately, explaining the circumstances in full. No extensions will be granted after the due date itself.

If illness or misadventure prevents you from submitting an assignment on time you should make an application for special consideration (see below).

5.5 Special Consideration and Supplementary examinations
UNSW policy and process for Special Consideration applies (see https://my.unsw.edu.au/student/atoz/SpecialConsideration.html). Specifically:

- Applications for special consideration (including supplementary examinations) must go through UNSW Central administration (within 3 working days of the assessment to which it refers) – applications will not be accepted by teaching staff;
- Applying for special consideration does not automatically mean that you will be granted additional assessment or that you will be awarded an amended result;
- If you are making an application for special consideration (through UNSW Central Administration) please notify your Lecturer in Charge;
- Please note: a register of applications for Special Consideration is maintained. History of previous applications for Special Consideration is taken into account when considering each case.

5.6 Assignment Format
Information about the format of assignments in this course is contained on the course Web CT Vista page.

6. ACADEMIC HONESTY AND PLAGIARISM
The University regards plagiarism as a form of academic misconduct, and has very strict rules regarding plagiarism. For full information regarding policies, penalties and information to help you avoid plagiarism see:
http://www.lc.unsw.edu.au/plagiarism/index.html

Plagiarism is the presentation of the thoughts or work of another as one's own.*
Examples include:
- direct duplication of the thoughts or work of another, including by copying work, or knowingly permitting it to be copied. This includes copying material, ideas or concepts from a book, article, report or other written document (whether published or unpublished), composition, artwork, design, drawing, circuitry, computer program or software, web site, Internet, other electronic resource, or another person’s assignment without appropriate acknowledgement;
paraphrasing another person’s work with very minor changes keeping the meaning, form and/or progression of ideas of the original;
• piecing together sections of the work of others into a new whole;
• presenting an assessment item as independent work when it has been produced in whole or part in collusion with other people, for example, another student or a tutor; and,
• claiming credit for a proportion a work contributed to a group assessment item that is greater than that actually contributed.†

Submitting an assessment item that has already been submitted for academic credit elsewhere may also be considered plagiarism.

The inclusion of the thoughts or work of another with attribution appropriate to the academic discipline does not amount to plagiarism.

Students are reminded of their Rights and Responsibilities in respect of plagiarism, as set out in the University Undergraduate and Postgraduate Handbooks, and are encouraged to seek advice from academic staff whenever necessary to ensure they avoid plagiarism in all its forms.

The Learning Centre website is the central University online resource for staff and student information on plagiarism and academic honesty. It can be located at:

www.lc.unsw.edu.au/plagiarism

The Learning Centre also provides substantial educational written materials, workshops, and tutorials to aid students, for example, in:

• correct referencing practices;
• paraphrasing, summarising, essay writing, and time management;
• appropriate use of, and attribution for, a range of materials including text, images, formulae and concepts.

Individual assistance is available on request from The Learning Centre.

Students are also reminded that careful time management is an important part of study and one of the identified causes of plagiarism is poor time management. Students should allow sufficient time for research, drafting, and the proper referencing of sources in preparing all assessment items.

* Based on that proposed to the University of Newcastle by the St James Ethics Centre. Used with kind permission from the University of Newcastle
† Adapted with kind permission from the University of Melbourne.

7. STUDENT RESOURCES

7.1 Course Resources

TEXTS AND RECOMMENDED READING

TEXTBOOKS

And either

Core Tax Legislation, CCH, 2007 edition

Or

Fundamental Tax Legislation, ATP, 2007 edition

DATABASES

Students should also refer to the following tax databases which can be accessed free of charge via the UNSW Library Web Site:

CCH Tax Library
Taxpoint (ATP)

Both of these sites enable full text retrieval of Income Tax Legislation, reports of tax cases, and ATO Rulings and Guidelines. These also contain extensive commentaries on Australian income tax.

The following databases which index journal articles can also be found on the UNSW Library Web Site:

AGIS (Attorney General’s Library database)
TAXABS (A database of journal articles on taxation)

WEBSITES

Australian Taxation Office www.ato.gov.au (use the legal research database)
Board of Taxation www.taxboard.gov.au
Treasurer www.treasurer.gov.au (useful for press releases)
Treasury www.treasury.gov.au
Austlii www.austlii.edu.au

JOURNALS

The UNSW Library holds the following journals dedicated to Australian taxation law:

Australian Tax Review (also available electronically via the Taxpoint site)
Australian Tax Forum
The Tax Specialist
Taxation In Australia
The Journal Of Australian Taxation
Revenue Law Journal

Numerous other Australian journals frequently contain articles on Australian taxation. References to them can be located via AGIS, TAXABS or using Sirius.

REFERENCE BOOKS

The following books, while sometimes somewhat out of date, are generally helpful. Care should be taken in using books published before the TLIP rewrite in 1997 as references in these books will always be to ITAA36.


**FURTHER READING:**

A list of further reading for each topic in the course and for case studies and problem topics will be placed on the course Web CT Vista page progressively throughout the academic session.

**WEB CT VISTA**

Students should access the Web CT Vista page for this course periodically. The URL for this page is [www.vista.elearning.unsw.edu.au](http://www.vista.elearning.unsw.edu.au) The Web CT Vista page will include: the course outline; reading lists for paper and problem topics; summaries of topics in the course; notes on case studies in the course; synopses of student papers and problem responses; details of your results in assessment tasks throughout the course; and a list of tax related internet sites.

**7.2 Other Resources, Support and Information**

The University and the Faculty provide a wide range of support services for students, including:

- **Learning and study support**
  - FCE Education Development Unit ([http://education.fce.unsw.edu.au](http://education.fce.unsw.edu.au))
  - UNSW Learning Centre ([http://www.lc.unsw.edu.au](http://www.lc.unsw.edu.au))
  - EdTec – WebCT Vista information ([http://www.edtec.unsw.edu.au](http://www.edtec.unsw.edu.au))

- **Counselling support** - [http://www.counselling.unsw.edu.au](http://www.counselling.unsw.edu.au)

- **Library training and support services** - [http://info.library.unsw.edu.au](http://info.library.unsw.edu.au)
• **Disability Support Services** – Those students who have a disability that requires some adjustment in their teaching or learning environment are encouraged to discuss their study needs with the Course Coordinator or the Equity Officer ([http://www.equity.unsw.edu.au/disabil.html](http://www.equity.unsw.edu.au/disabil.html)). Early notification is essential to enable any necessary adjustments to be made.

In addition, it is important that all students are familiar with University policies and procedures in relation to such issues as:

- **Examination procedures** and advice concerning illness or misadventure ([https://my.unsw.edu.au/student/academiclife/assessment/examinations/examinationrules.html](https://my.unsw.edu.au/student/academiclife/assessment/examinations/examinationrules.html))

### 8. CONTINUAL COURSE IMPROVEMENT

Each year feedback is sought from students and other stakeholders about the courses offered in the School and continual improvements are made based on this feedback. UNSW’s Course and Teaching Evaluation and Improvement (CATEI) Process ([http://www.ltu.unsw.edu.au/ref4-5-1_catei_process.cfm](http://www.ltu.unsw.edu.au/ref4-5-1_catei_process.cfm)) is one of the ways in which student evaluative feedback is gathered. Significant changes to courses and programs within the School are communicated to subsequent cohorts of students.

### 9. COURSE SCHEDULE

**Content Of Seminars**

**Week One – Introduction** (John Taylor)

Overview of course, provision of course information, allocation of problem topics and case studies.

**Week Two – Types Of Corporate Tax System**

- Overview of relevant corporate law considerations – separate legal entity doctrine – companies where liability is limited – listed v unlisted companies
- Review of tax policy considerations of horizontal and vertical equity
- Shareholder allocation systems – eg US Subchapter S Corporation – problems with widely held companies – problems where more than one class of shareholder
- Need for a corporate tax if shareholder allocation is not made
- Dividend exemption systems – eg Singapore – cf German 50% exemption system
- Dual income tax systems – eg Nordic countries and US
- Dividend deduction systems (eg Australian treatment of co-operatives)
- Shareholder credit systems where credit given whether or not corporate tax has been paid (eg UK and Canada)
- Compensatory tax style imputation systems (some European countries, Malaysia)
• Variable credit style imputation systems (eg Australia and New Zealand)

Text Reading For Week Two:

**UTL** 12.1 to 12.6 and 12.8 to 12.10

**UTL Web Page for 12.8** discussion of advantages and disadvantages of different forms of corporate tax system

**WEEK Three – The Company As A Tax Paying Entity**

• Definition of a company for tax purposes
• Payment of company tax by instalments
• Public v private companies
• Significance of the public v private distinction
• Treatment of losses in companies
• Other entities taxed like companies – limited partnerships – public trading trusts – corporate unit trusts

Text reading for Week Three

**UTL** 12.15 to 12.24, 12.26 to 12.34, 12.88 to 12.103, 12.141 to 12.147, 14.92 to 14.94, and 15.154 to 15.168

**Case Study One**

To take advantage of the growing population in Sydney, Merry, Jonah and Erin decided to build carparks throughout NSW and once completed, to manage these carparks. It is intended that, once the carparks are fully leased, they are to be sold.

Vision Pty Ltd (“Vision”) was incorporated on 1 July 1997 to undertake these activities. Merry, Jonah and Erin were the only shareholders and directors in the company in the following proportions:

Merry 55%
Jonah 20%
Erin 25%

From 1997 to 1999, Vision built multi-storey carparks throughout various CBDs in NSW and commenced to manage the carparks on 1 July 1999. Due to disagreements between the directors of the company, the carparks were badly managed and achieved dismal rental income. Vision incurred the following tax losses:

YE 30/6/2000 tax loss of $2.00 million
YE 30/6/2001 tax loss of $2.45 million

On 1 July 2001, Merry and Erin offered to purchase all of Jonah’s shares in the company. This offer was accepted on the same day. However, a downturn in the economy and rising interest rates saw Vision incur more losses in the years that followed:

YE 30/6/2002 tax loss of $2.50 million
YE 30/6/2003 tax loss of $2.00 million
On 31 December 2004, Rescue Pty Ltd (“Rescue”), a company owned by Merry 60% (together with his cousins, Frodo 20% and Pip 20%) offered to purchase all of Erin’s shares in Vision. The sale of Vision’s shares was completed on 30 June 2004.

Under the direction of its new directors, Vision sold the management rights to its car parks to Gandalf Pty Ltd (an unrelated company) for $1 million on 1 July 2004. Vision continued to construct car parks after 1 July 2004 but now sold management rights for each of the car parks that it constructed to Gandalf Pty Ltd with Vision retaining ownership of the car parks. In the year ending 30 June 2005 Vision made a profit of $500,000 from sale of management rights to car parks that it constructed in that year. On 1 December 2005 under the direction of its new management Vision began to construct and sell residential properties in Sydney. Following a property boom in Sydney, Vision made a profit of $6.35 million from its residential construction activities for the income year ended 30 June 2006.

(a) Discuss whether Vision can utilise its prior year tax losses in the years ending 30 June 2005 and 30 June 2006.

(b) How would your answer differ (if at all) if Rescue Pty Ltd had purchased Merry’s shares in Vision as well?

Week Four – Dividend And Non Share Dividend Distributions

- Rationale behind maintenance of a franking account (problem of ‘superintegration’)
- Franking account rules for company
- Definition of dividend s6(1)
- Inclusion of dividend in assessable income s44(1)
- Effect of receipt of a franked dividend on different types of shareholder including tax exempts and non residents
- Tax effects of receipt of dividend on value of shares in a closely held company
- Tax effects of distributions of corporate tax preferences as dividends
- Ability of company to retain tax preferred income
- Intercorporate dividends – elections in relation to losses – conversion of excess tax offsets into losses

Text reading for Week Four

UTL 12.34 to 12.61, 13.4 to 13.17, 13.33, 13.34 to 13.56 and 13.88 to 13.95

Case Study Two

Nostromo Ltd is an Australian resident company listed on the ASX. Its paid up capital is $1.2 billion represented by 1.2 billion ordinary shares. Most of its shareholders (95%) are Australian resident natural persons and institutions (superannuation funds, life insurance companies, and banks). Some of its shareholders (4%) are US individuals and institutions) and some (1%) are individuals resident in the newly independent South American state of Costaguana. Under Costaguana law all foreign source income of Costaguana residents is exempt from Costaguana tax. Australia does not have a double tax agreement with Costaguana. Under the Australia – United States Double Tax Agreement dividend withholding tax on dividends paid to portfolio shareholders is reduced to 15%. Under United States law portfolio
shareholders are entitled to a foreign tax credit for foreign withholding tax imposed on dividends but are not entitled to a foreign tax credit for underlying foreign corporate tax paid.

Nostromo Ltd has a wholly owned Costaguana subsidiary Gould Pty Ltd which conducts a silver mine in Costaguana. On 1 December 2006 Gould Pty Ltd pays a dividend of $150,000,000 to Nostromo Ltd. Note that this dividend will be non assessable non exempt income to Nostromo Ltd under ITAA36 s23AJ. Nostromo Ltd anticipates that its other income for the year ending 30 June 2007 will all be from Australian sources and will all be fully taxable at the corporate rate of 30%. Nostromo Ltd anticipates that its pre tax income from Australian sources for the year ending 30 June 2007 will be $50,000,000.

On 30 June 2006 Nostromo Ltd paid a dividend of 30c per share franked to 100%. This was consistent with its previous dividend policy. The payment left a zero balance in Nostromo Ltd’s franking account. The management of Nostromo Ltd considers that it will need to maintain a level of dividend payout that produces an equivalent after tax effect for its Australian resident shareholders in the year ending 30 June 2007. Based on the above information advise the management of Nostromo Ltd of:

(a) What its franking account balance is likely to be at year end 30 June 2007;

(b) What its options are in paying dividends to its resident shareholders in the year ending 30 June 2007 so as to produce an after tax effect equivalent to that obtained by those shareholders in the year ending 30 June 2006 (consider both the total amount of the dividend to be paid and the extent to which it should be franked)

(c) The tax consequences for Nostromo Ltd of all of the options that you consider in (b) above; and

(d) The tax consequences of the options that you consider in (b) above for shareholders who are resident in the United States and Costaguana.

Week Five – Other Types Of Corporate Distribution

- Return of capital
- Off market buy back
- On market buy back
- Liquidation
- Deemed dividends in closely held companies

Reading for Week Five

UTL 13.57 to 13.62 (and accompanying Web page discussion), 13.63 to 13.87 and 13.18 to 13.31.

Case Study Three

Amelia, Rebecca, Charles and William formed a company Vanity Fair Investments Pty Ltd on 1 January 1984. They each subscribed $50,000 for 50,000 $1 shares in
the company and become the directors of the company. On 1 February 1984 Vanity Fair Investments Pty Ltd purchased a terrace house in Waterloo in Sydney for $50,000. On 1 January 1986 Vanity Fair Investments Pty Ltd spent $150,000 on a portfolio invested in shares in companies listed on the ASX with a view to gaining dividend income. Shortly after the great stock market crash of 1997 Amelia, Rebecca, Charles and William worry that the end of civilisation is upon them and Vanity Fair Investments Pty Ltd sells its entire portfolio of shares for $100,000. Following its unsatisfactory experience in the share market the company invests the proceeds of the share sale in interest bearing deposits until changes to Australia’s capital gains tax come into effect in 1999. On 1 January 2000 Vanity Fair Investments Pty Ltd invests $100,000 in another portfolio of shares in companies listed on the ASX with a view to obtaining capital gains and dividend income. Following the housing and share market booms of the early 21st century Amelia, Rebecca, Charles and William worry that the end of civilisation is upon them and Vanity Fair Investments Pty Ltd sells the Waterloo terrace house for $1.5 million and sells its portfolio of shares on the same day for $200,000. Between 1984 and 30 June 2006 the only income that Vanity Fair Investments Pty Ltd derived was from interest and dividends. In each of these years the net investment income of the company was distributed to its shareholders as dividends. In the year ending 30 June 1998 the loss on the realisation of the shares was offset against the investment income before a dividend distribution was made. Assume that as at 1 July 2006 the balance in Vanity Fair Investments Pty Ltd’s franking account is zero. Assume also that Vanity Fair Investments Pty Ltd will not have any other tax liabilities for the year ending 30 June 2007. Following the sales of the company’s assets on 1 July 2006 the balance sheet of Vanity Fair Investments Pty Ltd is as follows:

**Assets**

| Cash on deposit | $1,750,000 |

**Equity**

| Capital profits reserve | $1,550,000 |
| Issued shares | $200,000 |

Amelia, Rebecca, Charles and William want the cash of the company to be made available to them. Discuss the possible implications for the company and for the shareholders of the following options:

(a) Declaration of a dividend followed by liquidation;
(b) Sale of all shares in the company in an arm’s length transaction with a third party;
(c) A return of capital without cancellation followed by liquidation;
(d) A return of capital with cancellation followed by liquidation;
(e) On off market buy back followed by liquidation;
(f) Liquidation.
Assume that Amelia, Rebecca, Charles and William are all Australian residents and are all top marginal rate taxpayers.

**Week Six – Anti Streaming And Anti Franking Credit Trading Rules**

- Anti dividend streaming rules
- Tainting and untainting the share capital account
- Anti capital benefit streaming rules
- Anti franking credit trading rules

**Text reading for Week Six**

*UTL* 12.62 to 12.87, 13.31, 13.96 to 13.106

*Consideration of case studies from Weeks 4 and 5 in light of rules discussed in Week 6*

**Week Seven – Partnerships**

- Nature and definition of a partnership
- Basic tax treatment – ITAA36 Div 5 and CGT treatment
- Creation of a partnership – CGT issues
- Derivation of partnership income – taxation via Div 5
- Disposal of partnership assets – CGT issues and reconciliation with Div 5 issues
- Assignment of partnership interests – derivation issues – CGT issues
- Franking credits flowing through partnerships
- Dissolution of partnership – s108-5(2)(c) and (d) assets

**Text reading for Week Seven**

*UTL* 14.1 to 14.55, 14.57 to 14.67 (but note Web Page update and further references on Web CT), and 14.68 to 14.91

**Case Study Four**

Athena, Jason and Clyde in January 2003 form a partnership to conduct a business as motor vehicle smash repairers. Each partner makes a capital contribution of $50,000. In the 2002-03 tax year the partnership acquires depreciable plant and a stock of parts to be used in repairing vehicles. The partnership borrows $60,000 from Big Bank Ltd to assist in the finance of the purchase of the plant and parts. The partnership traded profitably and in the 2003-04 tax year had a net income for tax purposes of $100,000.

On 1/8/04 Jason retires from the partnership. The partnership agreement contains a provision that the retirement of a partner will not cause the termination of the partnership and that the partnership will continue notwithstanding such retirement. Athena and Clyde purchase Jason’s interest in the partnership. Part of the payment that they make to Jason is $50,000 representing Jason’s share of work in progress outstanding as at the date of his retirement. On 1/10/04 Argo acquires a one third interest in the partnership by paying a premium to Athena and Clyde. On 1/12/04 the partnership sells some of its plant, namely chrome plating equipment, for $90,000.
The cost of this equipment was $80,000 and at the time of the sale its depreciated value was $72,000. The partnership does not replace the chrome plating equipment as the partners have decided that it is more economical to subcontract their chrome plating work. Due to illness Athena and Clyde have been unable to devote their full attention to the business of the partnership with the result that the partnership makes a net loss for the year ending 30 June 2005.

On 1/5/06 Clyde dies after a long illness. Athena and Argo continue to carry on the partnership together with Clyde's widow and sole executrix, Alice. The partnership has a small net income in the year ending 30/6/06. The net income is due to the normal repairing activities of the partnership.

On 1/8/06 the assets of the partnership, including motor vehicles that had been used by the partners on partnership business, are sold to Spraysure Pty Ltd at their book values. In addition in consideration of a payment of $1.00 each Athena, Argo and Alice enter into a covenant not to compete with Spraysure Pty Ltd. Neither Athena, Argo nor Alice has any connection with Spraysure Pty Ltd. The partnership is dissolved on 1/9/06.

Comment on the partnership income tax returns for the years ending 30/6/04, 30/6/05, 30/6/06 and the final return of the partnership. Comment on the income tax position of each person who was a partner at some point during the period dealt with in this problem. Include in your comments a discussion of any alternative ways in which the partnership may have dealt with the various events which have occurred.

**Week Eight – Taxation Of Trust Income**

- Nature of a trust
- Significant types of trust for tax purposes – fixed trust, unit trust, discretionary trust, trusts of deceased estates
- Division 6 taxation of trust income
- Disparities between trust income and net income
- ‘Proportions’ view v ‘Amounts’ view
- Treatment of trust losses
- Franking credits flowing through trusts

**Text reading for Week Eight**

*UTL* 15.1 to 15.88, 15.89 (note Web page update for 15.89 and material placed on Web CT), 15.169 to 15.174

**Case Study Five**

Magna Pty Ltd is an Australian resident company and is trustee of Imptrust a private unit trust which is an Australian resident trust estate. The unit holders in Imptrust are: Alien (a sui juris non-resident individual), Junior (a resident minor), Maxi Ltd (a resident listed public company) and Trusty Co Pty Ltd (a resident private company for tax purposes and the trustee of Mini Trust). Each unit holder in Imptrust is equally entitled to the income of the trust.

Mini Trust is a discretionary trust established by the Mini family. The trustee has a discretion to apply the income of the trust for the benefit of the following persons: Mrs Mini (a resident whose income from other sources is $100,000), Mr Mini (a resident
unemployed house husband whose income from other sources is nil), Little Mini 1 and Little Mini 2 (the children of Mrs and Mr Mini aged 8 and 5 respectively). The sole source of income of Mini Trust is distributions from Imptrust. Assume that Mini Trust has no expenses.

In the year ending 30/6/06 the income of Imptrust will comprise $700,000 of dividends franked to $300,000. What tax effects will the receipt of the franked dividends have on Magna Pty Ltd and on each of the unitholders in Imptrust? How should Trusty Co Pty Ltd exercise its discretion in relation to the income of the Mini Trust? Give separate answers to each of these questions on the following assumptions:

1. that the expenses incurred in earning the income of Imptrust were $200,000;
2. that the expenses incurred in earning the income of Imptrust were $700,000;
3. that the expenses incurred in earning the income of Imptrust were $1,400,000

Would your answer in any of the above scenarios differ if the expenses deductible for purposes of the Imptrust trust deed were $100,000 less than those deductible for income tax purposes?

How would your answer in any of the above scenarios differ if the income of Imptrust included an amount of $150,000 of interest in addition to the franked dividends?

How would your answer in the above scenarios differ if under the trust deed of the Imptrust only resident unit holders were entitled to dividend income flowing through the trust and only non resident unit holders were entitled to other income flowing through the trust.

Would your answer in the above scenarios differ if the amount of $150,000 included in the Division 6 calculation for Imptrust were a net capital gain arising from a sale of shares? Include in your answer a statement of any additional information which you would require before giving a definitive answer. In particular, consider what effect, if any, the definition of income in the Imptrust trust deed has and what is the effect, if any, if the capital beneficiaries in Imptrust or in the Mini Trust were different from the income beneficiaries.

Week Nine – CGT & Inter-Vivos Trusts Other Than Unit Trusts

- Nature of beneficiary’s interest in a fixed trust
- Nature of an object’s interest in a discretionary trust
- Position of default objects
- Concept of ‘absolute entitlement’
- Significance of beneficiary being or becoming ‘absolutely entitled’ (s106-50 and CGT event E5)
- Creation of trust (CGT events E1 and E2)
- Disposal of trust assets
- CGT events E3, E4, E6, E7 and E8
- Winding up a trust

Text reading for Week Nine
**Case Study Six**

Buzz Lightyear decided to set up the Galaxy discretionary trust. On 1 July 2003, Buzz declared that he will be holding an investment property valued at $100,000 and a set of coin collections valued at $4,000 on trust for his wife, Liz, his 23-year old son, Bob and a family friend, Woody. The investment property returns $12,000 in rent annually. Unless otherwise stated, Buzz Lightyear exercises his discretion to distribute the trust income equally amongst the beneficiaries.

In addition to the rental activities, the trust deed also provides that the Galaxy Trust can trade in shares only as directed by the beneficiaries of the trust. Where a beneficiary directs the trustee to purchase a particular share, the beneficiary must fund the acquisition by depositing sufficient funds into the trust bank account. The shares are then held exclusively for the benefit of that beneficiary.

On 1 July 2005, Liz deposits $100,000 with Galaxy Trust and instructs Galaxy Trust to purchase:
- 10,000 Qantas shares at $3.00 each
- 10,000 Telstra shares at $5.00 each
- 2,000 AMP shares at $10.00 each

On 18 August 2005, Bob deposits $20,000 with Galaxy Trust and instructs Galaxy Trust to purchase:
- 2,000 Qantas shares at $3.20 each
- 3,400 AMP shares at $4.00 each

On 31 August 2005, Galaxy Trust receives instruction to purchase 5000 Cochlear shares at $24.00 each. However, there were uncertainties over whether the instructions were received from Bob or Woody. This issue was litigated and on 1 June 2006, the court determined that the instruction came from Woody. At the time the court decision was handed down, Cochlear was trading on the ASX at $19.00.

In the 2007 income year, Galaxy Trust disposed of all its Qantas shares, again in accordance with instructions received from Liz and Bob:
- 6 July 2006 Liz instructed the trustee to sell 3000 Qantas shares at $3.30 each
- 31 July 2006 Liz instructed the trustee to sell 7000 Qantas shares at $3.50 each
- 16 August 2006 Bob instructed the trustee to sell 2000 Qantas shares at $3.60 each

On 30 June 2007, Buzz Lightyear decided that it would be in the beneficiaries’ best interests if some cash was left in the trust, in case of emergencies. However, rather than reduce the beneficiaries’ income distribution, Buzz, following the exercise of his discretion as to the trust income, disposes of the trust’s coin collection to Bob, in satisfaction of Bob’s entitlement to the trust income.

On 4 July 2007, the Galaxy discretionary trust disposed of the investment property for a capital gain of $400,000 and applies the 50% discount to the gain. The Galaxy discretionary trust distributes the entire capital gain to the beneficiaries.

Discuss the tax treatment for each beneficiary.
How would your answer if the trust had been established on 20th September 1985 and the trustee had chosen that frozen indexation rather than the 50% discount apply to the capital gain on the investment property.

**Week Ten – CGT & Unit Trusts**

- Relationship between unit holder’s interest and trust assets
- Basic treatment of unit trusts for CGT purposes
- Whether unitholders can ever be absolutely entitled as against the trustee
- Creation of unit trust – CGT events E1, E2 and E3
- CGT treatment of unit holder
- CGT event E4
- Winding up of unit trusts

**Text reading for Week Ten**

**UTL** 15.90 to 15.103, 15.104 to 15.112, 15.136 to 15.141, and 15.144.

**Case Study Seven**

The Ocean Unit Trust ("Ocean") was set up on 1 July 2002 by Marlin, Nemo and Dory each subscribing for 20,000 units in the Trust at $1.00 each (totalling $60,000). The Unit Trust was set up for the purpose of carrying on a property construction business. The business is carried out in a building located in the Sydney CBD, owned by Ocean. Surplus funds from the Trust’s construction activities are invested in shares in various companies and trusts.

On 30 June 2003, Ocean’s accounts showed surplus funds of $50,000. The next day, Ocean purchased 9,000 units in the Shark Unit Trust for $1.00 each. With the remainder of the surplus funds, Ocean purchased shares in various other companies on various dates.

On 31 March 2006, Shark Unit Trust made a net capital gain of $18,000 and distributed the entire amount to Ocean. The distribution comprised of $9,000 capital gain and $9,000 discount. For the year ended 30 June 2006, Ocean also derived $30,000 in dividends from its share investments. Ocean distributed the entire $48,000 to its beneficiaries in proportion to their unitholding in the Trust.

Subsequent to the distribution, Dory decided to transfer her units in Ocean to a third party, Manta, for its market value of $1.50 each. The contract for sale was entered into on 10 June 2006.

Assume Marlin, Nemo and Dory do not have any capital losses.

**Part A: Discuss the tax implications for Marlin, Nemo and Dory for the year ended 30 June 2005.**

On 8 July 2007, the beneficiaries of Ocean decided to wind up the Trust. Ocean sells all of its assets as follows:
- Units in Shark Unit Trust for $30,000
- 10,000 BHP shares for a capital gain of $18,000 after applying the 50% discount.
- 7,000 Telstra shares for a capital gain of $9,000 after applying the 50% discount.
- The building for a capital gain of $300,000 after applying the 50% discount. After applying the small business 50% reduction to this capital gain, Ocean distributes the profit from this sale to its unitholders in proportion to their unitholding.

These capital gains were distributed to the unitholders on the same day, in proportion to their unitholding. Assume Marlin, Nemo and Manta have the following capital losses:

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<tbody>
<tr>
<td>Marlin</td>
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<tr>
<td>Nemo</td>
<td>$5,000</td>
</tr>
<tr>
<td>Manta</td>
<td>$7,000</td>
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</tbody>
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**Part B: Discuss the tax implications for Marlin, Nemo and Manta for the year ended 30 June 2008. So far as the distribution relates to the capital gain on the building how would your answer differ if the unit trust had been established on 20 September 1985 and the trustee had chosen frozen indexation in relation to the capital gain on the building.**

**Week Eleven – Comparison Of Tax Treatment Of Entities**

- Formation
- Raising additional capital
- Operation and distributions
- Termination

*Paper presentations commence*

*Problem presentations commence*

**Week Twelve – Small Group Case Study On Comparative Entities**

The class will be divided into four groups. Each group will focus on a particular type of business entity. In week twelve each group will examine tax issues associated with the formation of the particular entity and with raising additional capital for the entity.

*Presentations by group members*

*Paper presentations continue*

*Problem presentations continue*

**Week Thirteen – Small Group Case Study On Comparative Entities**

The class will be divided into four groups. Each group will focus on a particular type of business entity. In week thirteen each group will examine tax issues associated with the operation of the entity and with distributions by the entity, including distributions of tax preferred income by the entity.

*Presentations by group members*

*Paper presentations continue*

*Problem presentations continue*
Week Fourteen – Small Group Case Study On Comparative Entities

The class will be divided into four groups. Each group will focus on a particular type of business entity. In week thirteen each group will examine tax issues associated with the termination of the entity and the sale of John’s interest in the entity.

Presentations by group members

Paper presentations continue

Problem presentations continue