

# **Solutions Manual**

to accompany

## **Australian Taxation**

**1<sup>st</sup> edition**

by

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# Chapter 1 – The Australian Tax System and Tax Formula

## Questions

### 1.1 Other than income tax, what other forms of taxation are present in Australia?

There are three other main Federal taxes in addition to income tax – they are Capital Gains Tax, Fringe Benefits Tax, and Goods and Services Tax. However, there are many other Federal taxes including customs duties, fuels excises, and resource taxes. There are also many State and Territory taxes. These include various stamp duties, payroll taxes, motor vehicle taxes, gambling taxes and land taxes. See further [1.1].

### 1.2 What is the doctrine of precedent? How does it help you in working out the legal significance of a tax case?

At the heart of the doctrine of precedent is the legal convention that judges will decide cases that are factually similar in the same way judges before them have decided those cases. This ensures a degree of consistency and predictability in judicial determination of factually similar cases. It is very important when considering judicial determinations in tax cases to bear in mind the level of Court hierarchy on the decision-making court as this will determine the extent to which the legal reasoning can be considered legally binding and consequently, be an authoritative statement of legal principle. Legal reasoning in tax cases in superior courts such as the High Court are the most legally significant according to the doctrine of precedent as the reasoning must be followed by judges in lower courts in factually similar cases. See further [1.2.2].

### 1.3 Under the Australian Constitution what type of power is the power to make laws with respect to taxation?

Under the Australian Constitution, taxation powers are a ‘concurrent’ power. Concurrent powers are shared by the States and Territories and the Australian Parliament. These are listed in the Constitution, but are not expressed as powers which exclusively belong to the Commonwealth Parliament. The taxation power is contained in section 51(ii) of the Australian Constitution. In situations where both the Commonwealth Parliament and State and Territories make inconsistent laws on the same subject matter, section 109 of the Australian Constitution says the Commonwealth law will take priority to the extent of any inconsistency.

### 1.4 What was the legal significance of the Uniform Tax Cases?

The first Commonwealth government income tax was introduced in 1915. However, it was not until an agreement with the States in 1942 that the States agreed not to exercise their powers to make laws with respect to taxes insofar as income tax was concerned. Initially, the proposal was intended to transfer powers to the Commonwealth Parliament to aid in funding the World War II war effort. The proposal was the subject of Constitutional challenge in the High Court by Victoria, South Australia, Queensland and Western Australia. There were two High Court challenges which have become known as the ‘Uniform Tax Cases’. The applicant States claimed the proposed new arrangements were in breach of section 51(ii) of the Constitution. Although the High Court affirmed the ability of the States to levy their own

income taxes, the High Court upheld the overall validity of the uniform tax arrangements. Since then we have had a single Australia-wide Commonwealth income tax.

### **1.5 What are the main powers and duties of the Commissioner of Taxation?**

The ATO has a range of significant powers and duties to ensure it can complete its important tax administration functions. Many of these are set out in the Tax Administration Act (TAA) 1953. These include powers to access information and premises. For example Section 353-15 of the TAA authorises the ATO to enter any land or building in order to access taxpayer books, documents or other property relevant to make tax enquiries. These powers extend to computerised records. The ATO can take copies of documents while they are there. Limits on the powers of the ATO to access information include limits on the ability to seize information without consent. In addition, the ATO will usually give notice of their intentions unless there is a real risk that information will be destroyed if advance notice is provided. The ATO also has significant powers to audit taxpayer returns and where the audit reveals inaccuracies, has power to amend the tax assessment of the taxpayer. See further [1.3.2]. The Commissioner must respect the rights of taxpayers in carrying out its functions and these obligations are set out in the Taxpayers' Charter – see [1.3.3].

### **1.6 What is a Tax Ruling? Why are Tax Rulings important and what is their legal force? Where would you find Tax Rulings on the Australian Taxation Office website?**

Tax Rulings set out the Commissioner's interpretation and position on the meaning and application of particular tax laws. There are two main categories of Rulings: 'Public Rulings' and 'Private Rulings'. Public Rulings are general in nature and do not apply to a specific taxpayer. Private rulings are rulings provided on request by a taxpayer seeking the view of the ATO on a particular tax issue being contemplated by the taxpayer. See further [1.3.2.4] Rulings are 'binding' on the Commissioner – see Section 357-60 Schedule 1 TAA. This means that if a taxpayer relies on a Ruling and correctly follows the interpretation of the law set out in the Ruling they will be protected against having to pay penalties if the Ruling turns out to be incorrect or the Commissioner subsequently changes their opinion. Rulings can be found in the ATO Legal Database on the Australian Taxation Office website.

### **1.7 What is the basic income tax formula? In what provision of the Income Tax Assessment Act is it set out?**

Income Tax Payable = (Taxable Income × Tax Rate) - Tax Offsets  
This formula is set out in subsection 4-10(3) of the ITAA97.

### **1.8 What is the difference between assessable income and taxable income?**

Taxable Income = Assessable Income - Deductions

Assessable income includes 'income according to ordinary concepts' and 'statutory income.' Essentially, income according to ordinary concepts is the concept of income as it has been developed and refined through the application of various indicators of income in tax cases over many years. In contrast, statutory income is income which is deemed to be income by virtue of the operation of particular statutory provisions — even if that income might not otherwise satisfy the various tests for income according to ordinary concepts.

A deduction reduces your assessable income to arrive at your 'taxable income' before tax is levied at the applicable tax rate. Similar to assessable income, a 'deduction' can be a 'general deduction' as a result of satisfying the basic indicators of deductibility which have been developed over many years of cases considering disputes concerning deductibility (and which are codified in s. 8-1 of the ITAA97) or because particular expenditure is expressly classified as a deduction in a specific statutory provision.

**1.9 What is the difference between a tax deduction and a tax offset? Give some examples of tax offsets.**

A deduction reduces assessable income to work out taxable income before tax payable is worked out. An offset applies after tax liability has been worked out and reduces the tax payable by the full amount of the offset - see s 4-10(3) of the ITAA97. Section 13-1 of the ITAA97 lists the dozens of income tax offsets that exist. Some of these are very specific and limited in their applicability. More commonly occurring offsets include the foreign income tax offset and low and low and middle income tax offsets.

**1.10 What is exempt income? Give examples.**

Exempt income is defined in s. 6-20 of the ITAA97 as income that is deemed exempt from being taxed by a provision of the tax law. Lists of types of exempt income are contained in ss. 11-5 and 11-15. Essentially exempt income is any income derived from tax exempt organisations, such as charities and religious institutions, or specific types of income earned by others who are not tax exempt — for example, certain allowances to defence force personnel.

## **Problems**

**1.11 Achmad has just received an amended notice of assessment from the ATO. The amendment has increased his tax liability by disallowing certain tax deductions he had previously claimed and been allowed. Achmad is unhappy and wishes to contest the amended assessment. He comes to you for advice. Give Achmad advice on the following:**

**(a) What are Achmad's objection options? How much time does he have to lodge his objection and what is the process for objecting?**

Objections must be lodged within four years of the issue of the decision being objected against in the case of a challenge to an income tax assessment. Objections must include full and detailed information to enable a decision on the objection to be made. This means it is not sufficient to simply complain that the tax assessed was too high; there must be sufficient facts and reasons provided to support that proposition. The ATO must make a decision on the objection within 60 days of being served with a notice to make a decision. The taxpayer can send this notice to the ATO if she or he has not received a response to the objection within 60 days of lodging it. See further [1.3.3.3]

**(b) If Achmad wishes to appeal an objection outcome to a Court or Tribunal what are his options. What path would you advise him to take and why?**

If the taxpayer is dissatisfied with the objection outcome, she or he can appeal to the AAT seeking a complete review of the decision (both the facts and the law) or appeal to the Federal Court on a question of error of law by the ATO. See further [1.2.3]. The Choice of appeal options depends on a number of factors. The Administrative Appeals Tribunal (AAT) is the only review body with the jurisdiction to 'stand in the shoes of the ATO' and effectively reconsider the entire case, including all the legal issues and the original facts presented by the taxpayer, and substituting its own factual and legal findings in the place of the ATO as the original decision-maker. In contrast, court appeals are limited to questions of law. The AAT is also a relatively cheaper option and a quicker and less formal alternative for having a dispute resolved. However, for resolving disputes concerning relatively complex and significant questions of law, the Federal Court may be the preferred option.

**1.12 Laura is single and has no dependents. For the 2019–20 financial year she earned \$105 000 in taxable income. She did not hold any private health insurance at any time during the financial year.**

**(a) Calculate the Medicare levy and any applicable Medicare Levy Surcharge payable by Laura for the 2019/20 financial year.**

The Medicare levy is 2% of taxable income. – ie \$2,100. However, in addition, Laura will need to pay an additional 1% Medicare Levy surcharge as a single person whose taxable income exceeds \$90,000. This means that on \$105,000 she would end up paying a total 3% in combined Medicare levy and Medicare Levy Surcharge in these circumstances – ie \$3,150.

**(b) Repeat the calculations, but this time assume Laura's taxable income was \$27 000.**

Low-income taxpayers do not have to pay any Medicare Levy — this applies if taxable income is equal to or below \$22 801 (for 2019–20). Laura's taxable income is just above this threshold so she would have to pay Medicare Levy calculated at \$419.90 ( $\$27,000 - \$22,801 \times 10\%$ ). However, given that her income does not exceed \$90,000, she would not be liable to pay any Medicare Levy Surcharge.

**1.13 Amna is an Australian resident. She is a full-time postgraduate business student and part-time tax tutor. For the 2019–20 financial year she has received the following amounts:**

- \$20 000 in rental income from overseas investment properties she owns.
- \$50 000 from her part-time private tutoring job.
- \$5000 University scholarship for her excellent grades last year.

**(a) What is Amna’s assessable income? What is Amna’s assessable income if she was a foreign resident for Australian tax purposes?**

As an Australian resident, Amna is liable to pay Australian income tax on all her income whether from Australian or overseas sources. Hence, her assessable income as an Australian tax resident would be \$70,000 (as the \$5,000 university scholarship income is treated as exempt income (s51-10 & s51-35 ITAA97)).

If she was a foreign resident, she is liable to pay tax only on Australian source income. On the facts provided, she would therefore not be liable to pay Australian tax on the \$20,000 of rental income from overseas properties. Hence her assessable income would be \$50,000.

**(b) What is the income tax payable by Amna for the 2019–20 financial year? What is the income tax payable if she was a foreign tax resident?**

Tax payable on \$70,000 as an Australian resident – \$3572 plus 32.5c for each \$1 over \$37 000 = \$14,297. In addition, she would be liable to pay 2% Medicare Levy – an additional \$1,400. [see Table 1.9]

Tax payable on \$50,000 as a foreign resident – Amna would not be entitled to a tax free threshold and would not be liable to pay any Medicare Levy. She would pay 32.5c for each \$1 of Australian source income – ie \$16,250 [see Table 1.11]

**1.14 For the 2019–20 financial year Li-You has earned \$75 000 of assessable income and has deductions of \$2000. She also has a foreign tax offset of \$3,000. Her employer has already withheld PAYG tax instalments of \$4,000 from her salary. Calculate the income tax payable by Li-You.**

|                             |                                                       |
|-----------------------------|-------------------------------------------------------|
| Assessable Income           | \$75,000                                              |
| Less:                       |                                                       |
| Deductions                  | \$2,000                                               |
| Taxable Income:             | \$73,000                                              |
| Tax Payable before offsets: | \$15,272 (3572 plus 32.5c for each \$1 over \$37 000) |
| Plus Medicare Levy          | <u>\$1,460</u>                                        |
|                             | \$16,732                                              |
| Less                        |                                                       |
| Foreign Tax Offset          | \$3,000                                               |
| PAYG already paid           | \$4,000                                               |
| TAX PAYABLE:                | \$9,732                                               |

[See Table 1.9 for Resident Tax Rates for 2019/20]

**1.15 Superstar Tax Pty Ltd is an Australian company with a \$1million dollar turnover. For the 2019–20 financial year, the company earns \$100 000 in taxable income. Calculate the tax payable by Superstar Tax. How would your answer be different if the annual turnover of the company for the 2019–20 financial year was \$60 million dollars?**

As a company with an aggregated turnover less than \$50 million for the 2019–20 income year, Superstar Tax Pty Ltd will pay tax at a flat rate of 27.5% on its taxable income of \$100,000. Hence, its tax liability is \$27,500. If its turnover was in excess of \$60 million, the company would be liable to pay tax at a rate of 30% on its \$100,000 in income – ie \$30,000. [See Table 1.8]