

Taxation (1) 2009

**Exam
suggested
solutions and
examiners'
feedback**

COMMONWEALTH OF AUSTRALIA

Copyright Regulations 1969

WARNING

Copyright owners are entitled to take legal action against persons who infringe their copyright. A reproduction of material that is protected by copyright may be a copyright infringement. Certain dealings with copyright will not constitute an infringement, including:

- > a reproduction that is a fair dealing under the *Copyright Act 1968* (the Act), including a fair dealing for the purposes of research or study; or
- > a reproduction that is authorised by the copyright owner.

It is a fair dealing to make a reproduction for the purposes of research or study, of one or more articles on the same subject in a periodical publication, or, in the case of any other work, of a reasonable portion of a work.

In the case of a published work in hardcopy form that is not less than 10 pages and is not an artistic work, 10% of the number of pages, or one chapter, is a reasonable portion.

In the case of a published work in electronic form only, a reasonable portion is not more than, in the aggregate, 10% of the number of words in the work.

More extensive reproduction may constitute fair dealing. To determine whether it does, it is necessary to have regard to the criteria set out in subsection 40(2) of the Act.

A court may impose penalties and award damages in relation to offences and infringements relating to copyright material.

Higher penalties may apply, and higher damages may be awarded, for offences and infringements involving the conversion of material into digital or electronic form.

Examiners' feedback

Congratulations on completing the *Taxation (1) 2009* exam.

Now that you have received your exam result, we have provided you with this document to help you understand your mark.

In addition to the candidate learning pack (CLP), the following key resources are available on *myCA* to support you:

- > *Taxation (1) 2009 exam*
- > *Taxation (1) 2009 main exam links to CLP* – provides links from the main exam paper to material covered in the candidate learning pack (CLP)
- > *Exam self-reflection template* – designed for use with the above two resources
- > *Learning & assessment guide (LAG)* – contains general information regarding exams in the Chartered Accountants Program (the LAG is issued to all candidates when they start the Program)
- > CLP activity solutions.

We recommend that you use all five resources in tandem to help you reflect on your exam performance.

Marking process

Marking of exam scripts (exam answers) involves detailed quality control procedures. The marking process involves each exam being individually assessed against the specified criteria for the respective questions. Exam marking is undertaken in one location for each question and over one weekend.

Before marking commences, all Chartered Accountants on the respective marking panels meet and discuss the question they will be marking. This discussion ensures that each member of the marking panel understands the marking criteria against which that question is being assessed. Each member of the marking panel then individually marks the same script for that question.

When each member of the marking panel has marked the same script, the marking panel regroups to discuss the marks awarded and any areas of the marking criteria that require further clarification. This process is then repeated until all members of the panel are marking consistently. Each marker is then assigned a batch of scripts to mark.

During the marking process, a minimum of 10% of the scripts is audited. This involves one of the marking auditors independently assessing a script without any knowledge of the mark already assigned to it by the original marker. If a discrepancy exists between the original mark and the auditor's mark, both markers review the script and come to a consensus. If necessary, a second auditor may be asked to mark the script.

A further re-mark is therefore not required. Requests for re-marks will not be accepted.

Overall feedback

The pass rate for *Taxation (1) 2009* was 73.6%. The highest overall mark was 91.

	Highest marks awarded per question	Maximum score
Question 1	12	13
Question 2	12	12
Question 3	11.5	13
Question 4	12	12

Overall comments

For candidates who did not perform well in this exam, common issues were:

- > poor exam technique – not quantifying answers or showing all workings when these were specific requirements of the question
- > poor time management – not allocating adequate time to each question and accordingly not providing a response to all parts of each question
- > limited technical understanding of tax concepts – accordingly not being able to apply the concepts to the issue at hand.

Question 1 – suggested solution (13 marks)

Item	Explanation	Amount \$
Sales	Assessable: <i>Carden's</i> or any relevant case on cash/accruals (<i>Barratt</i>)	3,000,000
Early payment discounts	Discounts are not assessable. Only net selling price is assessable: <i>Ballarat Brewing</i>	0
Interest	Not derived until received: s. 6-5	0
Purchase of stock from Thailand	\$2 million/22.52 = \$88,809.95 s. 960-50(6) item 8	(88,810)
FX Gain	Liability (\$2 million ÷ 22.52) = \$88,810 Payment (\$2 million ÷ 29.56) = <u>(\$67,659)</u> FX Gain \$21,151 s. 775-55	21,151
Meal entertainment	50% x \$5,000 = \$2,500 s. 51AEA ITAA1936 or s. 32-20	(2,500)
Fines	Not deductible: s. 26-5	0
Excess closing stock over opening stock	\$2.8 million – \$2.5 million = \$300,000 s. 70-35	300,000
Pref share dividends	Not deductible Equity interest because of any of the following: > share > dividend is contingent on profits Debt test: > No ENCO to pay dividend as contingent on profits > ENCO to pay issue price > As more than 10 years, must discount the ENCO benefits > As a result of discounting, ENCO benefits to be provided will be less than issue price Debt test failed	0
Legal fees – share issue	\$9,000 ÷ 5 = \$1,800 s. 40-880	(1,800)
Po's taxable income		3,228,041

Question 1 – examiners’ feedback

General comments

The objective of this question was to test candidates’ knowledge of the assessable income, deduction, trading stock, foreign currency translation and gain/loss and debt/equity rules.

Overall, candidates answered this question reasonably well, reflecting their level of understanding of the issues being addressed. Generally, candidates attempted all parts of the question. Candidates who lost marks in this part did not understand the concepts examined and, therefore, applied them incorrectly, or failed to recognise the issues altogether.

Specific feedback on each issue examined in the question follows.

Sales and early payment discounts

- > Most candidates were able to correctly recognise that Po must use the accruals basis of accounting to account for its sales, and that the early payment discount was not assessable (there was no need to make any adjustments as the \$3 million sales already excluded the discounts).
- > Candidates who cited an appropriate case to support their answer were able to access the full marks allocated to the issue, as this was a requirement of the question.

Interest

- > Candidates who performed well identified that the interest income was not derived until 2 July 2008, and therefore was excluded from Po’s 2008 taxable income.
- > Some candidates incorrectly translated the interest income into Australian income, and included the interest in Po’s taxable income.

Purchase of stock

- > Candidates who performed well recognised that there were two tax issues which affected Po’s 2008 taxable income: the purchase of the stock and the subsequent payment of it.
- > The purchase of the trading stock was deductible. In translating the foreign currency, candidates should have converted applying the exchange rate on 30 April 2008.
- > Only better-performing candidates recognised that Po had a taxable FX gain. FRE4 occurred as there was a difference in the FX rate between the time the expense was incurred and when it was paid.

Meal entertainment expenses

- > Candidates who performed well recognised that Po could either calculate FBT by applying the actual method or the 50/50 split method, and that the amount of the entertainment expense subject to FBT was deductible. Accordingly, these candidates identified that the 50/50 split method would reduce the overall income tax and FBT payable by Po.

Parking fines

- > Most candidates were able to recognise that fines were not deductible and cited the correct section.
- > Some candidates incorrectly cited s. 8-1 as the relevant section. Specific sections override the general provisions.

Movement in stock

- > Most candidates recognised that Po was assessable for the excess of closing stock over the opening stock value.
- > Some candidates did not correctly account for the difference between closing and opening stock, and incorrectly identified a loss. Regardless of the closing value used, Po would have had an assessable amount (refer s. 70-35(2)).

Debt–Equity issue

- > Candidates who performed well were very methodical in applying the debt–equity rules when determining the tax treatment of the dividend payment. These candidates applied both the debt and equity test before concluding that the dividend payment was not deductible.
- > Candidates who did not perform well concluded that the interest was debt or equity by applying one test. In many instances, those candidates who adopted this approach concluded that the interest was debt, and therefore that the dividend payment was deductible. This analysis failed to recognise that present value must be used when calculating the ENCO provided.
- > Alternatively, some candidates only applied the equity test, concluding that the dividend payment was not deductible. This analysis was incomplete, resulting in candidates not receiving full marks.

Legal fees – share issue

- > Candidates who performed well identified that the legal fees associated with the share issue was blackhole expenditure.
- > Some candidates claimed a deduction of \$9,000 by applying either s. 8-1 or s. 25-25. Section 8-1 is not correct – the deduction would be denied because the outgoing relates to the issue of share capital, which is capital in nature. Section 25-25 is not appropriate – to apply this section the taxpayer needs to borrow money. Again, this is not the case – the legal fees relate to Po’s raising of share capital.

Common mistakes

- > Lack of appropriate legislative references or case law to support assertions. This was a specific requirement of the question, and candidates who did not include this information did not receive full marks for the question.

Links to CLP

Question	Part	CLP unit	CLP; Worked examples; activities; other references
1		1	CLP pp. 31, 37 and 51; Activity 20 – Part C and E
		2	CLP pp. 92–93
		3	CLP pp. 37–49; Worked example 4; Activity 4; Activity 17 – Part E
		4	CLP pp. 93–95; Worked example 18; Activity 10; Activity 12 – Part D Extension project – Part A

Question 2 – suggested solution (12 marks)

- (a) Identification of acquisitions, as well as calculation of GST

Watercolour painting

$$\$4,510 \div 11 = \$410$$

Shares in listed Australian health care provider

Nil as financial supply

Brokerage acquisition and disposal

$$\$39.95 \div 11 = \$3.63$$

Options, loan and interest

Nil as financial supply

Accounting fees

$$\$2,552 \div 11 = \$232$$

Golf club fees

$$\$13,750 \div 11 = \$1,250$$

Alfie is not registered or required to be registered for GST, and therefore will not be entitled to an input tax credit for any GST included in the acquisition cost of goods and services. Candidates were only awarded marks if they referred to input tax credits from Alfie's perspective

The GST will be included in the cost base of assets for CGT purposes where relevant, for example, brokerage or watercolour painting

- (b) **Watercolour painting**

This is a collectable (s. 108-10(2))

As acquired for more than \$500 the capital gain is **not** disregarded

Capital proceeds	12,000	
Cost base		
1 st element	<u>4,510</u>	
Capital gain	7,490	
Less: c/f capital loss	<u>8,000</u>	(only against this gain)
Capital loss to carry fwd	<u>(510)</u>	

Shares in listed Australian health care provider

Capital proceeds

$$15,000 \text{ shares @ } \$13.59 \quad 203,850$$

Cost base

$$1^{\text{st}} \text{ element } 15,000 \text{ shares @ } 12.72 \quad 190,800$$

$$2^{\text{nd}} \text{ element brokerage fees} \quad \underline{80} \text{ (rounded)}$$

$$\text{Capital gain} \quad \underline{12,970}$$

Subject to discounting as held for at least 12 months

Options

CGT event C2 on lapse or no capital proceeds on lapse of options

$$\text{Capital loss} \quad (10,000)$$

Net capital gain	
Watercolour	n/a
Shares	12,970
Options	<u>(10,000)</u> (not including collectables loss)
Net capital gain	2,970
Less: Discount	<u>(1,485)</u>
Net capital gain included in ITR	<u>1,485</u>
Capital loss available for carry forward	<u>510</u>

(c) Type of benefit – all are expense payment fringe benefits

Interest on loan

No otherwise deductible amount as loan used to purchase Alfie's home

No GST will be included as this is a financial supply, therefore this will be a type 2 benefit

Taxable value \$31,000

$$\begin{aligned} \text{Gross taxable value} &= \$31,000 \times 1.8692 \\ &= \$57,945 \end{aligned}$$

Accounting fees

As this relates to assistance with determining the tax treatment, the otherwise deductible rule will apply such that there is no FBT payable in respect of the accounting fees

Golf club fees

No otherwise deductible amount as this is private expenditure

Type 1 benefit

$$\begin{aligned} \text{Taxable value} &= \$13,750 \\ \text{Gross taxable value} &= \$13,750 \times 2.0647 \\ &= \$28,390 \end{aligned}$$

Total FBT payable

$$(\$57,945 + \$28,390) \times 46.5\% = \$40,146 \text{ (rounded)}$$

Question 2 – examiners’ feedback

General comments

The objective of this question was to test candidates’ knowledge of the interaction of the income tax, GST and FBT rules.

As anticipated, candidates performed reasonably well in this question overall. Generally, candidates attempted all parts of the question. Candidates who lost marks in this question generally did not demonstrate an understanding of the concepts examined.

Candidates performed relatively better in Part C of the question.

Specific feedback for each part of the question is provided below.

Part A

This question required candidates to calculate the GST included in several listed items, and then explain how the GST included in those items would be treated for GST and income tax purposes by Alfie, who is not registered for GST.

Relative to the rest of the parts of this question, Part A was handled poorly.

Common mistakes

- > Some candidates incorrectly discussed how the good or service acquired would be treated for GST and income tax purposes (e.g. the deductibility of the expense) rather than discussing how the GST included in the good or service acquired was treated for GST and income tax purposes. Other candidates inappropriately discussed the GST treatment of the sale of the various items, rather than their acquisition.
- > Some candidates did not recognise that Alfie had acquired accounting services and membership of the golf club. Candidates who performed well explained that the GST was zero in respect of the shares and options acquired by Alfie, because these are financial supplies that are input taxed; they also identified that brokerage would be a taxable supply and hence include GST.
- > A few candidates discussed how GST was calculated, rather than actually calculating the amount of GST, resulting in these candidates not attaining full marks for this part of the question.

Part B

This question required candidates to demonstrate an understanding of basic capital gains tax (CGT) concepts, including identifying type of assets and the rules associated with capital losses.

Part B was handled reasonably well by candidates.

Common mistakes

- > Most candidates showed a reasonable understanding of the basics of CGT. However many candidates incorrectly concluded that the watercolour painting was a personal use asset rather than a collectable.
- > Not all candidates recognised that the brokerage on the disposal of the shares should be added to the cost base of the shares as an incidental cost, rather than reducing the capital proceeds.
- > Many candidates concluded that CGT event C3 happened in relation to the lapse of the options. CGT event C2 was the relevant CGT event for Alfie, as CGT event C3 would only happen with respect to the company issuing the options.

- > Candidates performed well when they applied capital losses against capital gains before discounting any resultant net capital gain. Better candidates applied the carried forward loss from the collectable against the capital gain from the watercolour painting, and recognised that there would remain a balance of capital losses to carry forward.

Part C

This question examined candidates' understanding of the FBT treatment of several expense payment benefits.

Most candidates performed well in this part of the question.

Common mistakes

- > Some candidates incorrectly concluded that the payment of interest was a loan fringe benefit, and therefore calculated the taxable value by applying 8.05% to the interest amount.
- > Candidates who performed well recognised that the accountant fees would have been deductible under s. 25-5, and therefore that the taxable value of this fringe benefit was reduced to zero by operation of the otherwise deductible rule.
- > Some candidates incorrectly stated that the golf club membership fees were exempt under s. 58Y. This section applies in specific and limited circumstances, and would not apply to Alfie's golf club membership fees.
- > Some candidates failed to gross-up the taxable value of the fringe benefits before calculating the FBT payable, or applied the same gross-up rate to both the interest and the golf club membership fees.

Links to CLP

Question	Part	CLP unit	CLP; Worked examples; activities; other references
2	A	1	CLP pp. 125; Figures 6 and 7; Worked examples 22 and 23
		2	CLP pp. 19–20
	B	2	CLP pp. 16,18,23,27–28,38; Activity 1, 2; Activity 15 – Part A
	C	1	CLP pp. 157; Worked examples 29 and 32; Activity 18; Activity 20 – Part F

Question 3 – suggested solution (13 marks)

Part A (5 marks)

1. Interest is assessable.
2. Interest needs to be grossed up for withholding tax.
3. A foreign tax credit is generally available in relation to the interest withholding tax.
4. Dividend is exempt.
5. No foreign tax credit is available in relation to the dividend withholding tax.
6. Operating expenses are deductible.
7. Purchase of trading stock is deductible.
8. Closing stock value is assessable.
9. There is a prima facie loss of \$100,000 (\$1 million - \$1.1 million) and thus the foreign tax credit is not available.
10. Revalue certain stock items so that taxable income is $\$100,000 \div 30\% = \$333,333$ (or consequential).

Part B (5 marks)

JoJo's deductions:

Computer	\$50,000
Demolition balancing loss	\$6,000
Tax fees	\$2,000
Software	\$32,000
Prepaid Super	\$40,000
	<hr/>
	\$130,000

Notes:

1. Cost of plant = \$90,000 + \$10,000 = \$100,000. These are both element 1 costs (refer s. 40-185 example 2). Depreciation = $\$100,000 \times (200\% \div 4) = \$50,000$.
2. The demolition costs form part of the cost of the demolished computer (second element).
3. Tax fees are not capital (refer s. 25-5(4)).
4. Software is depreciated at 40% prime cost.
5. Super is not subject to the prepayment rules because it is not deductible under s. 8-1.

Part C (3 marks)

Redundancy

Because Ronny is over 65, the redundancy concessions do not apply to him. Therefore, the redundancy payment would be treated as a termination payment. As the total termination amount will exceed the \$140,000 threshold (see below), the redundancy payment will be taxed at 46.5% = \$9,300.

Annual Leave

Because Ronny is over 65, the redundancy payment was not a 'genuine redundancy payment'. Accordingly, the annual leave will be taxed at 46.5% = \$4,650.

Termination Payment

$\$140,000 \times 16.5\%$	=	\$23,100
$\$10,000 \times 46.5\%$	=	\$4,650
Total	=	<hr/>
		\$27,750

Question 3 – examiners’ feedback

General comments

The objective of this question was to test candidates’ knowledge of general income tax issues on a range of tax transactions, calculating deductions available to a non-SBE taxpayer and the taxation consequences of receiving various payments associated with the termination of an individual.

Overall, candidates either did reasonably well or performed poorly in answering this question, reflecting their level of understanding of the issues being addressed. Generally, candidates attempted all parts of the question. Candidates who lost marks in this part generally did not understand the concepts examined and, therefore, applied them incorrectly, or failed to recognise the issues altogether.

Specific feedback on each part of the question is provided below.

Part A

The objective of Part A was to simulate a real-life scenario in which candidates had to advise a client on a number of simple issues regarding assessable income, allowable deductions, trading stock and foreign tax credits. The question was designed to be practical, and candidates were expected to apply the facts and reach a conclusion about what the key issues were.

Some candidates raised questions and did not apply the facts to identify the issue. This was not appropriate. Issues had to be drawn from the facts provided. Some candidates also provided indecisive responses (for example, that the New Zealand dividend may be exempt). There was adequate information in the facts for candidates to comment clearly and decisively on the issue.

Common mistakes

Some candidates were unable to identify the practical, ‘bread-and-butter’ issues. Candidates who performed well were methodical in their responses, identifying the specific issue associated with each listed fact. Candidates who struggled with Part A failed to identify the following basic concepts:

- > that the foreign interest income is assessable
- > that the withholding tax needs to be grossed up
- > that a foreign tax credit is available on the interest
- > that the New Zealand dividend is exempt under s. 23AJ
- > that no foreign tax credit is available on the dividend
- > that the operating expenses were deductible
- > that the purchase of trading stock was deductible
- > that the closing stock was assessable.

Candidates who performed well provided a technical solution to a practical impediment. The question specifically stated that no foreign income was going to be derived in the future (even though there was a \$100,000 foreign tax credit) and that there was a profit in stock. The facts also showed that Ampersound had a current year tax loss of \$100,000 (being \$1 million of foreign interest income, including withholding tax, less \$1.1 million of deductions). Better-performing candidates advised the client to revalue the stock so that taxable income was \$333,333, resulting in \$100,000 tax payable thereon, with the \$100,000 foreign tax credit reducing that tax to nil.

Part B

The main objective of Part B was to determine whether candidates understood which costs should be absorbed into the cost of plant. Candidates were also required to determine what other deductions were available.

Common mistakes

In relation to the plant:

- > not including the travel costs under the first element
- > incorrectly including tax advice and/or demolition costs of the old computer under the first element
- > not using diminishing value, even though the question required candidates to minimise tax.

In relation to the tax advice:

- > failing to actually state that \$2,000 was deductible
- > failing to justify why the tax fees were deductible (i.e. they were not capital or they were a tax-related expense).

In relation to the demolition of the old computer:

- > failing to recognise that the demolition costs go into the balancing loss calculation (i.e. \$5,000 + \$1,000)
- > incorrectly deducting the demolition costs from the balancing loss calculation.

In relation to the software:

- > incorrectly depreciating the software over two years, when the statutory period is 2.5 years (i.e. 40%/40%/20%)
- > incorrectly using the diminishing value method, when there is a statutory requirement to use prime cost.

In relation to superannuation:

- > failing to actually state that \$40,000 was deductible
- > failing to recognise that the prepayment provisions do not prevent superannuation from being deductible upfront, because the prepayment provisions only apply to amounts which are deductible under s. 8-1.

Part C

The main objective of Part C was to determine whether candidates could determine the tax payable on a simple redundancy payment.

Common mistakes

- > failing to recognise that the employee was over 65 and therefore did not qualify for the redundancy provisions (therefore the whole payment was treated as an ETP)
- > where candidates identified that the genuine redundancy payment had an exempt component, very few candidates used the completed years of service in their calculations. Many candidates incorrectly calculated the exempt amount by multiplying the amount by 2.5 years
- > incorrectly calculating a concessional tax payable on the annual leave, even though the employee was more than 65 years old and did not qualify for the redundancy provisions (and therefore the concessional tax payable rules on annual leave did not apply)
- > failing to add the Medicare levy to the tax payable on the annual leave and on the ETP.

Links to CLP

Candidates who performed well in this question would have reviewed:

Question	Part	CLP unit	CLP; Worked examples; activities; other references
3	A	1	CLP pp. 80–81, Activity 20 – Part C
		3	Activity 17 – Parts A and C
		4	CLP pp. 48–49 and 54; Worked examples 10 and 12, Activity 12 – Part C
	B	1	CLP pp. 65–66, 74
		2	CLP pp. 85–87; Activity 12 Extension project – Part A
	C	1	CLP pp. 43–46; Worked example 7; Activity 4

Question 4 – suggested solution (12 marks)

	Explanation	Amount \$
Assessable income		
D Co's attributable income	D Co's income is all active and therefore D Co passes the active income test	–
Dividend from D Co	Exempt (s. 23AJ)	–
C Co's capital gain	Assessable	200,000
Less c/f capital loss	$(\$500,000 \div \$2,000,000) \times \$200,000$	(50,000)
C Co's interest income	Assessable	60,000
Dividend from B Co and C Co	Ignore intra-group dividends TR 2004/11	–
Deductions		
B Co's interest deduction	Deductible under s. 25-90 because earning s. 23AJ income	(15,000)
C Co's expenses relating to interest	\$5,000 quarantined s. 79D (interest income category)	(60,000)
Taxable income		135,000
Tax @ 30%		40,500
Foreign tax credit	Passive income: Capital gain + interest – quarantined expense $= \$200,000 \times 30\% = \$60,000$ FTC = \$20,000	(20,000)
Tax payable		20,500

Exclusions

The foreign withholding tax on the dividend paid by D Co (\$10,000) is not eligible for a foreign tax credit because the dividend is 'non-assessable non-exempt income' under s. 23AJ.

Question 4 – examiners’ feedback

General comments

The objective of this question was to test candidates’ ability to apply basic international tax principles in a consolidated group context.

Candidates either identified the principles involved and performed reasonably well, or were unable to recognise the issues and struggled to answer the question.

From an exam technique viewpoint, some candidates did not attempt to answer Question 4. Either candidates allocated their time poorly and simply did not have adequate time to answer Question 4, or they did not have the technical expertise to answer the question and therefore did not attempt the question. In order to maximise marks, candidates should attempt to break down what appears to be a complex question into concepts that they understand (e.g. the removal of inter-entity dividend payments). Such an approach could assist these candidates to access the easier marks.

Specific feedback on the issues examined in the question follows.

To perform well, candidates had to recognise that under the single entity rule the head company (A Co) is the only entity that is recognised for tax purposes. As stated in the CLP (refer Unit 4, p. 14), the ‘treatment of a subsidiary member under the single entity rule is almost akin to treating each subsidiary member as if it were a branch (rather than a separate entity) of the head company’. This was relevant for B Co and C Co. Effectively, the transactions of B Co and C Co become those of A Co.

Common mistakes

The common mistakes in applying the tax consolidation rules are outlined below.

- > not applying the single entity rule by ignoring the inter-entity dividends received by A Co from B Co and C Co. Candidates incorrectly grossed up the dividends for the franking offset, and applied the tax offset to reduce the tax payable
- > incorrectly applying the available fraction against the capital loss, rather than the capital gain contribution by the loss-transferring subsidiary
- > incorrectly applying the consolidation loss utilisation rules to non-transferred losses.

The common mistakes made in applying the international tax rules are outlined below.

- > not identifying that D Co – a wholly-owned non-resident company – is a controlled foreign company. Many candidates incorrectly concluded that a non-resident company earning only foreign income had no Australian income tax implications. Alternatively, some candidates concluded that D Co had no Australian income tax implications, as the non-resident company was not part of the tax consolidated group. This rationale is incorrect. While D Co is not part of the tax consolidated group, the attribution regime still requires consideration
- > some candidates did not identify that the dividend from D Co is not assessable because it was a non-portfolio dividend (refer s. 23AJ)
- > not identifying that the quarantining rules applied to limit the deduction for the related interest expenses to the foreign interest income derived, being foreign income of the same class
- > incorrectly treating the payment of foreign taxes as deductions
- > incorrectly calculating A Co’s foreign tax credit entitlement. Some candidates incorrectly applied the imputation system for the foreign income, treating the foreign taxes paid as franking credits and claiming a corresponding imputation offset

- > failing to recognise that foreign tax credit entitlement is based on a 'class-by-class' basis
- > not appreciating that interest incurred to earn s. 23AJ non-exempt, non-assessable income is not deductible under s. 8-1. Some candidates who made this connection did not realise that s. 25-90 allowed deduction for interest incurred in deriving s. 23AJ dividends.

Links to CLP

Question	Part	CLP unit	CLP; Worked examples; activities; other references
4		4	CLP pp. 14–16, 62–63 and 78–81; Worked examples 2, 10 and 12; Activity 6; Activity 12 – Parts B and C