Case study on taxation law

Finance, Investment

The taxation of the capital gains made during the disposal of the property by James will be considered under the Income Tax Assessment Act of 1997, section 104-105 which deals with capital gains for individuals. This is wholly embedded in the Goods and services Tax act of 1999 (div 9-11). Using this act, considerations will be made on each tax event under the capital gains tax and analysis made on how each will be treated under the act. In the disposal of the property, either a capital gain or a capital loss is made, and such a gain or loss will have to be declared on the income tax returns by James for this particular tax period.

James will also have to declare his employment income for this year, in addition to the capital gain or loss either gained or incurred from the disposal of the property. A declaration of any investment income will also have to be made in accordance with the income Tax Assessment of 1997, and in this case will include income resulting from investment in shares and interest gained from the loans he has advanced to other parties which do not constitute the operations of the business of the orchid farm or which do not fall under the deductions made during the disposal of the farm.

The property was acquired prior to 20th September 1985 when the capital gains tax was introduced in Australia and would thus ordinarily not be subject to the capital gains tax. However, for this property, the capital gains tax is applicable because substantial additions were made on the property in the form of horse stables in the year 2000 in the amount of $290, 000. Since the property was acquired at a cost of $200, 000, the reduced cost base of the property becomes $90, 000 as at the year 2000. This principle of reducing the cost base of the property is informed by the Income Tax

Assessment Act of 1997 which stipulates the reduction of the cost of an asset by the amount employed in the capital modification of the asset so as to improve its value or maintain its current operational state. According to GST act s9- 15, this is necessitates a consideration for the supply of such property.

Further alterations were made to the property after the decision to convert it to an orchid farm which further altered its cost base. Of the amount advanced as a loan to James, $150, 000 were utilised for soil testing on the property, and as such qualify as capital additions to the property since they were used to improve the property for the purpose of generating income. Considering this, the capital loss on the farm then becomes $60, 000 as at five years ago. This is according to the Australian Income Tax Assessment Act of 1997 which stipulates that the costs associated with making capital modifications to a property will be deducted from the cost base of the property so as to reach a reduced cost for the property for the purposes of calculations of the capital gain or loss made or incurred. This is one of the events described in the act.

An amount of $100, 000 and $10, 000 was utilised for market research and advertisement for the business respectively. According to the Capital gains Tax Act of 1985, this will not be considered as capital costs to the property since they were aimed at improving the operational capacity of a business at a particular financial period and did not in any way contribute to the improvement of the property at that time. These costs should ideally have been reported as expenses at that particular financial year when they were incurred and contributed to the determination of the operating business income of the farm at that particular financial year. This is because the transactions are completed during the course of the enterprise GST s9-20 and the enterprise is registered div20.

Since an amount of $150, 000 was utilised in the improvement of the property (soil testing) and was sourced from a loan, the costs of financing the loan to the extent of this amount will be regarded as a cost of owning the asset. This implies that a cost of owning the asset amounting to $12, 000 per annum will be considered since this is the amount paid as interest to the bank relating to the cost of the farm. This cost will amount to $60, 000 for the five years since the loan was taken. This will further increase the capital loss on the property to $120, 000. The reduced cost of the property to this point has gone beyond the original cost of the property, and this has the effect of further reducing the amount that will be deductible from the capital proceeds gained from the disposal of the asset.

In preparation for the sale of the property; demolitions, clearing and subdividing the land, the cost of $800, 000 incurred will be considered as capital costs to improve the property and will thus be deducted to bring the capital loss on the property to $920, 000. This is because this amount was employed towards making of the property suitable for disposal. The amounts incurred for agent fees and advertising cost will also be deducted, bringing the capital loss of the property at this point to $940, 000.

The property was disposed for capital proceeds amounting to $2. 5 million. Thus, the net capital gain after making the reduced cost of the property will amount to the difference between the proceeds from the disposal and the capital loss incurred to that point. This means that James has made a net capital gain of $1. 56 million which will be considered.

In the California Copper Syndicate Ltd V Harris (1904), it was found that obtaining an enhanced price from the disposal of a capital asset may not necessarily constitute a profit which will be deemed an income for taxation purposes. This is because such an enhanced price may be merely an enhancement in value. For such an enhancement to be considered as tax assessable, it should result as a gain from the operation of a business carried out for profit making. In the case of James, the capital gain made on the sale of the property will be assessable for tax purposes since it was made from the disposal of a continuing business operation for profit. The alterations made on the property in the form of divisions, clearing and provision of power indicate a profit motive and further cement the fact that the operation are made for the business motive of making profits. This decision is further reinforced by the Myer Emporium case which affirmed the decision made on California Copper Syndicate Ltd V Harris (1904).

Since there is a capital gain in this case, there will be no need of either indexing or discounting the capital gain since that is only applicable to capital losses where the capital proceeds from the disposal of an asset are lower than the reduced cost of the asset. This implies that James will declare a capital gain in the amount of $1. 56 million in his annual tax returns to the tax authorities.

The earnings from shares amounting to $55, 000 will be declared under income from investments. This is because the amount is earned from investments made in the stock market in the form of shares.

The amount of $50, 000 spent on legal defence in the malpractice allegation case will not be deductible in the income tax assessment for the year. This is because according to the Australian Income Tax Assessment Act of 1997, legal fees incurred in the course of duty are not indicated as tax deductible. The costs incurred in defending himself did not constitute part of his ordinary day to day business and activities as a doctor. The act provides for the expenses related to the payment of union fees as deductible expenses which can be claimed in tax assessments, and it thus follows that such unions would provide the legal backing required as in this case of accusations of professional malpractice. This implies that such an expense cannot thus be claimed for a tax deduction, and should be ideally be borne by the professional union to which contributions made to them are expenses claimed as tax deductible.

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