PITCHER PARTNERS
ACCOUNTANTS AUDITORS & ADVISORS

Level 6
161 Collins Street
Melbourne
Victoria 3000

Postal Address:
GPO Box 5193 AA
Melbourne Vic 3001
Australia

Tel: 03 9289 9999
Fax: 03 9289 9977

DX Address:
DX 501 Melbourne

Website: www.pitcher.com.au
E-mail: partners@pitcher.com.au

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T A JONAS, K R HALL, T J BENFOLD, D B RANKIN, A R FITZPATRICK, I D STEWART, R RIGONI, R CUMMINGS, D A THOMSON, M J LANGHAMMER, J BRAZZALE, S SCHONBERG, G E WALSH, S P CATLIN, G E BLASHKI, C J TATTERSON, P T RILEY, N J FLAVEL, M W PRINGLE, G M RAMBALDI, D A KNOWLES, F J ZAHRA, M C HAY, C S BUCKLAND
CONSULTANT: R G PITCHER

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Report by Pitcher Partners

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Pitcher Partners address is-

Level 6, 161 Collins Street, Melbourne.

Contact: Michael Hay
Partner
Telephone: (03) 9289 9920
Facsimile: (03) 9289 9961
E-mail: mhay@pitcher.com.au

Mark Northeast
Director
Telephone: (03) 9289 9050
Facsimile: (03) 9289 9961
E-mail: mnorthea@pitcher.com.au

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This report has been prepared as follows:

Part A Introduction

Part B Key Findings

Part C Approach Taken/Assumptions

Part D Case Studies

It is difficult to comment fully in the absence of full details of these measures and in the absence of the details of anticipated consequential and transitional measures. We would be pleased to provide further analysis and comment once further information is available.

PART A – INTRODUCTION

Pitcher Partners is a large Melbourne based business advisory and public accounting firm with approximately 300 Partners and staff and 2,000 clients conducting businesses. We welcome the opportunity to report on Version 2 of the Tax Value Method Prototype.

Pitcher Partners predominantly services the "middle market". Our clients include smaller publicly listed entities, large privately owned groups and family owned businesses. Significantly, our client base includes many business carried on by individuals, partnerships, trusts and private companies.

We welcome the opportunity to provide input into the development of Tax Value Methodology and in particular with a view to raising issues relevant to small and medium enterprises (SME).

Our focus in reviewing available materials and testing client based data has therefore been to consider the likely impact, feasibility of application, compliance cost and risk for inadvertent error, of these measures to SMEs. Whilst the focus has been on SMEs, many of the comments may be equally valid when considered in the context of all entities impacted.

PART B - KEY FINDINGS

Objectives

Our objectives have been to test client data (both actual and adapted) to:

1. Determine whether the correct answer is achieved;

2. Comment on the difficulties / ease of application of the Prototype; and

3. Advise of what data was available.

Part C of this report outlines the process or methods we have followed.

1. Was the correct result achieved?

Whilst we found that it was generally possible to get to the correct result, we found the legislation difficult to apply to achieve that outcome.

This necessarily assumes that the financial statements that our testing was based upon captured all relevant assets and liabilities. In this regard due care may be required when transactions are "off balance sheet". Further, any pure "cash" transactions not recorded in balance sheets were not captured in the testing. It is also noted that significant gaps in the draft legislation currently exist and it was not possible to properly test data against complete legislation.

Paradoxically where draft legislation was provided, this often delayed the testing process given our relative lack of familiarity with these provisions and the release of provisions during the testing process. In many cases, we believed that we were aware of what the correct outcome should be, (in terms of Division 5 of the Prototype Draft Legislation ("PDL")), yet found the application of the provisions difficult.

An example of an area that we considered relatively straight forward (until Version 2 of the Prototype was released) was the application of the legislation to determine the taxable income of certain financial non-current assets and non-current liabilities[1]. Unfortunately, the release of Division 45 (in its current form) only served to provide uncertainty in terms of its drafting (and in the absence of Explanatory Materials).

We believe that conceptually the calculation of taxable income under the PDL requires a paradigm shift from profit and loss focus to balance sheet focus.

[1] Where current and non-current liabilities are referred to in this report, our reference is to the balance sheet classification. Division 45 impacts on certain assets and liabilities that do not require payment within 12 months.

However, we have found (on limited testing) that the shortest route to the calculation of taxable income appears to be the Profit Reconciliation Method (see Part C). Therefore, the challenge, particularly for SME's and their advisors, will be to be able to conceptually use a "Tax Values" balance sheet to calculate taxable income and understand how the profit and loss statement information might be of assistance in that process.

For completeness we note many of the current issues involving the capital/revenue distinction may not be relevant if this methodology is adopted. Our limited testing of the PDL indicates that further guidance of issues involving "holding" an asset, "having" a liability and calculation of taxable values would be useful. Further, the fewer Income Tax Adjustments a taxpayer has, the easier it is to apply TVM.

We would recommend further identification of areas of where accounting/taxation differences arise. Once identified, a decision can then be made as to whether or not the provisions tested can (or should) cater for these differences or whether Income Tax Adjustments should be made.

2. *Difficulties/Ease of Application of the Prototype*

As noted above, the PDL is relatively simple to apply on a conceptual basis.

When compared to existing legislation we found that the number of line items required to calculate taxable income in the case studies undertaken were:

	Existing Legislation	Profit Reconciliation Method	Balance Sheet Method
Case Study 1	18	9	28
Case Study 2	17	13	21
Case Study 3	6	3	10
Case Study 4	14	10	18

Fundamental areas of difficulty were:

- Ensuring that all relevant "assets" and "liabilities" were identified. Assets and liabilities are broadly defined in the PDL and it is expected that an ongoing challenge may be to identify "assets" and "liabilities" not shown on financial statements. In this regard "off balance sheet" transactions may need to be captured and given "tax values".
- As noted below data was not readily available to determine gross "Receipts" and "Payments". Transactions that purely occur in "cash" will not be readily apparent from balance sheet information.
- We had particular difficulty in determining the taxable value of non-current financial assets and liabilities where reference was required to Division 45. We anticipate however that this may be remedied by drafting.

- Leases are relatively common transactions for SME's. Again we had particular difficulty in this area. As financial leases are transactions that give rise to assets and liabilities recorded in financial statements, but which should not have "Tax Values", it may be relevant to determine a common approach to these types of transactions or provide clarification in the legislation.

- Some difficulties were experienced with the Equity section of the balance sheet. Whilst rules have been released for companies and the treatment of Paid Up Capital, similar rules have not been drafted for other entities. In addition, it was unclear how retained profits, reserves and distributions from all entities should be treated.

- Tax effect accounting entries typically recorded by companies require further consideration to ensure that the correct outcome is achieved in the company scenario.

- Many SME's use trusts to conduct their business. Guidance is required as to how "beneficiaries entitlements" that appear in the liabilities section of the balance sheet, and "trust entitlements" that appear as "assets" in the balance sheet are to be treated.

Further detail of these issues and other difficulties noted are contained in the notes and assumptions to the case studies.

3. Availability of Data

In all case studies we found that balance sheets and profit and loss statements were either available, or could be easily constructed.

Information relating to all "Receipts" and "Payments" was not readily available, however as noted in the case studies this in itself did not present difficulties.

In short we found that the clients tested had relevant financial data to apply TVM as drafted to date in the PDL.

PART C – APPROACH TAKEN

Part C of this report outlines the approach taken by Pitcher Partners to calculate taxable income. For completeness a description is provided of the working schedule developed to assist in this process.

Two Approaches to Net Income

Section 5-55 of the Prototype Draft Legislation states that Net Income is:

> Receipts - Payments +/- Net change in tax value of assets and liabilities.

We believe that this can usually be calculated from existing client financial information in one of two ways:

- Profit Reconciliation Method; or
- Balance Sheet Method

Neither method is "absolutely true" to the Prototype Draft Legislation ("PDL"). However, neither current practice nor ATO published tax return forms are "true" to existing legislation. That is, presently practitioners do not add up every item of assessable income and deduct every allowable deduction to arrive at taxable income.

In this regard we also note that *Review of Business Taxation - A Tax System Redesigned" (RBT)* at page 163 envisaged that the cash flow/tax value approach will not, of itself, require taxpayers to change the way they currently calculate taxable income.

Profit Reconciliation Method

Method Statement

Step 1	Calculate Operating Profit/(Loss) before Tax - extracted from financial statements.
Step 2	Identify differences between movements in Book Values of assets/liabilities and movements in Tax Values of assets/liabilities.
Step 3	Add/subtract step 2 to/from Step 1 to determine Net Income.

Explanation of Method Statement

Step 1

This method starts with the Operating Profit/(Loss) before Tax for the business.

This figure is broadly representative of the net difference between the businesses opening balance sheet and closing balance sheet. In other words the profit and loss statement is the "link" for accounting purposes between the businesses balance sheet at the commencement of the year and the businesses balance sheet or statement of financial position at the end of the year.

Thus, for accounting purposes the "Operating Profit/(Loss) before Tax" figure incorporates relevant, receipts, payments and asset and liability movements.

Step 2

Our working schedule shows complete opening and closing "Book Value" and "Tax Value" balance sheets. From that schedule movements in Book Values and movements in Tax Values are identified. Where differences in movements arise, they are noted and added to or subtracted from "Operating Profit / (loss) before tax".

Following the introduction of GST and the adoption of computer packages by many SME clients (such as MYOB), "Book Value" balance sheets are often currently prepared even by individual taxpayers.

The preparation of a "Tax Value" balance sheet is not currently prepared. However, as you will note from the case studies, the majority of items in our "Tax Value" balance sheets are identical to items in our "Book Value" balance sheets. We would anticipate however, that in many cases (and with practice and with, say, previous year TVM worksheets to work off) that it will be possible to identify where movements in "Book Values" and "Tax Values" differ for many SMEs. Thus, it may not ultimately be necessary to draft complete "Tax Value" balance sheets to identify such differences.

However, until familiarly is achieved with these measures, complete "Tax Value" balance sheets may assist as a tool in checking whether the right Net Income result is achieved. The preparation of complete "Tax Value" balance sheets may also lessen the scope for initial inadvertent error.

Balance Sheet Method

Method Statement

Step 1	Prepare a "Tax Value" balance sheet at the start and end of the income tax year for all assets and liabilities.
Step 2	Identify movements in Tax Values of assets/liabilities.
Step 3	Aggregate all positive and negative movements to arrive at Net Income.

Explanation of Method Statement

Step 1

This method involves treating all balance sheet items as assets or liabilities.

Relevantly, this also includes all money accounts, the net movement in which comprises "Receipts less Payments". Alternatively, this approach may be seen as effectively choosing to have "money accounts" (refer section 5-60 (4) of the PDL) and treating money account balances with financial institutions as "assets and liabilities" that have Tax Values.

We anticipate that many taxpayers will be able to use "Book Value" balance sheets as a basis for the construction of most of the "Tax Value" balance sheet. As noted above, from our case studies, many of the "values" for assets and liabilities are identical for "Book" and "Tax" purposes.

Step 2

This involves identifying and recording movements in the "Tax Values" of assets and liabilities.

Step 3

The aggregate of positive and negative balances will require due care. As increases/decreases in assets are additions/subtractions to Net Income and increases/decreases in liabilities are subtractions/additions respectively to Net Income, scope appears to arise for inadvertent arithmetical errors, at least initially.

Which Method?

Whilst the Profit Reconciliation Method appears to require a more developed understanding of how TVM works, it appears to provide the shortest route to the determination of Net Income.

On the other hand the Balance Sheet Method might be seen as more "true" to the prototype as it is currently drafted. We anticipate that being "true" to the prototype or any ultimate legislation will be of little priority to practitioners but that getting to the right result in the shortest possible time will be important.

Whilst the Balance Sheet Method may require more work, an advantage in using this method may be perceived as ultimately resulting in less errors. Put another way, the more short cuts taken, the greater potential for errors.

Whilst we do not anticipate universal acceptable of either method, familiarisation with these measures may see some businesses initially adopt the Balance Sheet Method and then move to the Profit Reconciliation Method.

Working Schedule

Our Working Schedule contains relevant information to calculate Net Income under the;

- Profit Reconciliation Method; or
- Balance Sheet Method

The Working Schedule is an Excel Worksheet designed to capture information relevant for determining Net Income under either of the methods noted above.

From left to right the Working Schedule comprises:

- Listing of Balance Sheet items
  - As these items only comprise assets and liabilities that are recorded in financial statements, a weakness of the Working Schedule (and the Balance Sheet Method) is that some assets and liabilities that are currently recognised for taxation purposes, but not for book purposes may not be captured. Examples might include assets leased under an operating lease that contains an option to purchase – that is assets where existing legislation deems notional ownership. Another example, might be borrowing costs which are capitalised for taxation purposes but expensed for book purposes.
- Notes
  - This column is only inserted for the purpose of this report
- Section References
  - This column is only included for the purpose of this report
  - Tax Value Method PDL Sections - in normal font.
  - RBT/Existing legislation - in italics.
- Account – "Book Values"
  - Existing client data has been adapted and inserted onto the Working Schedule. Where Pitcher Partners is involved in the preparation of or audit of client accounts, this generally involves transposing electronic data. In other cases "Book Value" data needed to be keyed into the template manually.
- "Tax Values"
  - For the purpose of this exercise every line item was reviewed against the PDL, RBT, or current legislation to arrive at appropriate "Tax Values".

- With familiarity we anticipate that the relevant process will become to only insert amounts in this column for "Tax Values" where accounts / tax differences arise. This assumes that the relevant method to be adopted will be the Profit Reconciliation Method.

• Profit Reconciliation Method – Excess of Tax Over Accounts (Shaded Column)

  - Reconciling items between "Operating Profit / (Loss) before Tax" and Net Income are included in this column.

• Receipts / Payments (Business) and (Non Business)

  - In most cases these columns would be deleted. They are only included on our Working Schedule to highlight:

    Money Accounts – Receipts / Payments

    Non-business Receipts / Payments

• Balance Sheet Method – Movement in Tax Values (shaded Column)

  - Includes all movements in "Tax Values"

  - The number of line items shown in our case studies in this column indicates to us, that practitioners would generally opt for the Profit Reconciliation Method. Clients might however adopt either method dependent on their software and existing or available systems.

• Taxable Income Adjustments

  - Ultimately the number of entries in this column will be determined by Tax Policy objectives.

• Unused Tax Losses

  - The client's carried forward tax (revenue) losses are entered here. It is noted however, that this column could be incorporated into the Taxable Income Adjustments column, but has been kept separate given the order of application of losses (against exempt income and net income).

  - Capital losses recouped might be captured in Taxable Income Adjustments.

• Total

  - Comprises "Tax Values" Movements, Income Tax Adjustments, and Unused Tax Losses.

PART D - CASE STUDIES

CASE STUDY 1 - INDIVIDUAL

1. Background

This case study looks at a pharmacist carrying on significant business operations involving multiple shops.

The pharmacist also derives investment income including trust distributions and dividends.

2. Key Findings

Is the correct answer achieved?

- Yes, under either the Profit Reconciliation Method or the Balance Sheet Method.

Difficulties/Ease of Application

- This case study proved to be relatively straight forward with the exception of applying the PDL to leases. Full testing however could not be carried out without further legislation. For example, it was not clear how trust entitlements should be treated. Please refer to the "notes and assumptions" to our Working Schedule for further detail.

Availability of Data

- Relevant data used comprise a profit and loss statement and a balance sheet. This data is attached.

  Given the size of the individual's business operations and the use of a computerised accounting system, balance sheets were available.

  Relevantly, data concerning all "Receipts" and "Payments" was not readily available. However, the lack of this data did not prevent attainment of the correct answer.

TAXABLE INCOME OVERVIEW

CASE 1 - INDIVIDUAL (CARRYING ON A BUSINESS)
METHOD 1 - PROFIT RECONCILIATION METHOD

Operating Profit / (Loss) before Tax	(2,021,547)
Excess of Movement in Tax Values over Account Values - See Schedule	14,669
	(2,006,878)
Non Business Receipts / (Payments) - See Schedule	2,453,529
Net Income	**446,651**
Taxable Income Adjustments - See Schedule	24,495
Unused Tax Losses - See Schedule	(471,146)
Total	-

CASE 1 - INDIVIDUAL (CARRYING ON A BUSINESS)
METHOD 2 - BALANCE SHEET METHOD

Receipts Less Payments (Business) - See Schedule	(329,407)
Net Change in Tax Values of Assets and Liabilities - See Schedule	(1,677,471)
	(2,006,878)
Receipts Less Payments (Non Business) - See Schedule	2,453,529
Net Income	**446,651**
Taxable Income Adjustment - See Schedule	24,495
Unused Tax Losses	(471,146)
Total	-

PITCHER PARTNERS

CASE 1 - INDIVIDUAL
WORKING SCHEDULE

Taxable Income - 5-15	Notes	Section	Accounts Opening Value	Accounts Closing Value	Accounts Movement	Tax Opening Value	Tax Closing Value	Tax Movement	Profit Method Excess of Tax Over Accounts	Receipts/ Payments (Business)	Receipts/ Payments (Non Business)	Balance Sheet Method Movement in Tax Values	Taxable Income Adj'ment	Unused Tax Losses	Total
Current Assets					-			-	-						-
Cash on Hand	1, 2	5-55, 5-60	5,440	5,440	-	5,440	5,440	-	-	-					-
Petty Cash	1, 2	5-55, 5-60	500	-	(500)	500	-	(500)	-	(500)					(500)
Cash on deposit	1, 2	5-55, 5-60	1,500	1,500	-	1,500	1,500	-	-	-					-
Trade Debtors	4	6-40 Item 6	250,974	383,398	132,424	250,974	383,398	132,424	-			132,424			132,424
Sundry Debtors	4	6-40 Item 6	-	7,628	7,628	-	7,628	7,628	-			7,628			7,628
Other debtors	4	6-40 Item 6	320,310	31,068	(289,242)	320,310	31,068	(289,242)	-			(289,242)			(289,242)
Prepayments	5	6-40 Item 3	92,278	88,284	(3,994)	92,278	88,284	(3,994)	-			(3,994)			(3,994)
Stock on Hand	6	6-40 Item 2, 38-20	1,955,818	2,021,107	65,289	1,955,818	2,021,107	65,289	-			65,289			65,289
Investments					-			-	-						-
Listed Shares		6-40 Item 9	312,480	422,106	109,626	312,480	422,106	109,626	-			109,626			109,626
Loans Receivable					-			-	-						-
Loans Receivable - Current	4	6-40 Item 6	332,608	705,467	372,859	332,608	705,467	372,859	-			372,859			372,859
Loans Receivable - Non Current	4	6-40 Item 7	-	5,336	5,336	-	5,336	5,336	-			5,336			5,336
Fixed Assets (Held by Taxpayer)					-			-	-						-
Leasehold improvements (Cost less decline)	9	6-21, 40-35	15,719	35,579	19,860	15,719	35,579	19,860	-			19,860			19,860
Motor vehicles (Cost less decline)	8	40-35	35,153	27,701	(7,452)	35,153	27,701	(7,452)	-			(7,452)			(7,452)
Office furniture and equipment (Cost less decline)	8	40-35	11,505	9,053	(2,452)	11,505	9,053	(2,452)	-			(2,452)			(2,452)
Furniture and Fittings (Cost less decline)	8	40-35	2,596	2,076	(520)	2,596	2,076	(520)	-			(520)			(520)
Furniture and Fittings (Cost less decline)	8	40-35	66,456	52,836	(13,620)	66,456	52,836	(13,620)	-			(13,620)			(13,620)
Fixtures and Fittings (Cost less decline)	8	40-35	156,853	162,829	5,976	156,853	162,829	5,976	-			5,976			5,976
Fixtures and Fittings (Cost less decline)	8	40-35	215,181	182,348	(32,833)	215,181	182,348	(32,833)	-			(32,833)			(32,833)
Leased Assets					-			-	-						-
Plant and Equipment Under Lease	7	6-20, 6-21	212,179	146,158	(66,021)	-	-	-	66,021			-			-
Intangibles					-			-	-						-
Approval Number		6-40(1) Item 9	45,000	45,000	-	45,000	45,000	-	-			-			-
Purchased Goodwill		6-40(1) Item 8(a)	2,399,986	2,399,986	-	2,399,986	2,399,986	-	-			-			-
Amortisation			(343,501)	(343,501)	-	-	-	-	-			-			-
Current Liabilities					-			-	-						-
Bank overdraft	1, 2	5-55, 5-60	(165,948)	(494,855)	(328,907)	(165,948)	(494,855)	(328,907)	-	(328,907)					(328,907)
Trade Creditors	11	7-75(1) Item 5	(1,406,905)	(1,149,547)	257,358	(1,406,905)	(1,149,547)	257,358	-			257,358			257,358
Sundry Creditors	11	7-75(1) Item 5	(2,927)	-	2,927	(2,927)	-	2,927	-			2,927			2,927
Other Creditors	11	7-75(1) Item 5	(103,639)	(37,098)	66,541	(103,639)	(37,098)	66,541	-			66,541			66,541
Loans Payable					-			-	-						-
Loans Payable - Current	11	7-75(1) Item 5	(2,147,371)	(4,615,015)	(2,467,644)	(2,147,371)	(4,615,015)	(2,467,644)	-			(2,467,644)			(2,467,644)
Loans Payable - Bank - Non Current	11	7-75(1) Item 8	(1,091,570)	(1,010,000)	81,570	(1,091,570)	(1,010,000)	81,570	-			81,570			81,570
Loans Payable - Other - Non Current	11	7-75(1) Item 8	(4,742,644)	(4,735,086)	7,558	(4,742,644)	(4,735,086)	7,558	-			7,558			7,558
Leases and HP's					-			-	-						-
Lease - Current	7		(55,460)	(57,255)	(1,795)			-	1,795						-
Lease - Non Current	7		(162,339)	(105,084)	57,255			-	(57,255)						-
HP - Current		7-75(1) Item 5	(5,333)	(6,067)	(734)	(5,333)	(6,067)	(734)	-			(734)			(734)
HP - Non Current		7-75(1) Item 8	(22,079)	(16,011)	6,068	(22,079)	(16,011)	6,068	-			6,068			6,068
Provisions					-			-	-						-
Employee Entitlements		7-23 Item 1	(41,055)	(45,163)	(4,108)			-	4,108			-			-
Equity					-			-	-						-

CASE 1 - INDIVIDUAL
WORKING SCHEDULE

Taxable Income - 5-15	Notes	Section	Accounts Opening Value	Accounts Closing Value	Accounts Movement	Tax Opening Value	Tax Closing Value	Tax Movement	[illegible] Method Excess of Tax Over Accounts	Receipts/ Payments (Business)	Receipts/ Payments (Non Business)	Balance Sheet Method Movement In Tax Values	Taxable Income Adj'ment	Unused Tax Losses	Total
Cash Movement															
Non-Business Receipts and Payments								-							-
Receipt of Trust Distribution	10	5-55, 5-60			-			-			2,449,384				2,449,384
Receipt of Trust Distribution	10	5-55, 5-60			-			-			3,199				3,199
Receipt of Trust Distribution (Capital Gain)	10	5-55, 5-60			-			-			941				941
Interest on Joint Account		5-55, 5-60			-			-			13				13
Bank charges		5-55, 5-60			-			-			(8)				(8)
Net Income			(3,858,235)	(5,879,782)	(2,021,547)	(3,468,059)	(5,474,937)	(2,006,878)	14,669	(329,407)	2,453,529	(1,677,471)	-	-	446,651
					-										-
Income Tax Adjustments					-			-							-
Prepayments	5	*82KZMB ITAA 1936*			-			-					21,796		21,796
Non-Allowable Donations/Gifts		5-95 Item 10			-			-					74		74
Allowable Donations/Gifts		5-95 Item 11			-			-					(5,400)		(5,400)
Previously Capitalised Borrowing Costs	12	*25-25 ITAA 1997*			-			-					(1,408)		(1,408)
Dividend Gross-up		*160AQT ITAA 1936*			-			-					9,433		9,433
					-			-							-
Tax Losses					-			-							-
Carry Forward Tax Losses Utilised					-			-						(471,146)	(471,146)
					-			-							-
Total Taxable Income			(3,858,235)	(5,879,782)	(2,021,547)	(3,468,059)	(5,474,937)	(2,006,878)	14,669	(329,407)	2,453,529	(1,677,471)	24,495	(471,146)	-

PITCHER PARTNERS

CASE 1 - INDIVIDUAL
NOTES AND ASSUMPTIONS

1. Money Accounts

Actual receipts and payments were not currently available. Therefore, "money accounts" were effectively treated as assets and liabilities. Any "cash" transactions not put through the bank accounts could not be identified by simply recording movements in bank accounts. This is no different to the current situation where limitations exist in collecting and recording "cash economy" transactions.

2. Election for Money Accounts

Under s. 5-65 of the Prototype Draft Legislation ("PDL"), an entity can choose to treat an account maintained with an Authorised Deposit-taking Institution ("ADI") as a "money account" for an income year. Using the balance sheet method, we note that there does not appear to be any difference (except where cash balances are held) if the accounts are not treated as "money accounts", and instead are treated as assets or liabilities. This is consistent with the PDL which allows for alternate treatment of "money accounts". This assumes that the tax value of the asset was the amount that the taxpayer had a right to receive that is due and payable (s. 6-40 Item 5 of the PDL). A similar assumption has been made in respect of the bank overdraft liability (s. 7-75, Item 4 of the PDL).

3. Property

S. 6-20 Item 1 of the PDL requires determination of whether an asset is property. Further guidance on what is property would be useful.

4. Current and Non-Current Receivables

It was not entirely clear whether the current receivables would fall within s. 6-40 Item 5 or 6 of PDL, although the outcome under either appears to be the same.

It appears that non-current receivables would fall within s. 6-40 Item 7. The tax value of this asset under Division 45 appears to equate to book value, or "cost". The non-current receivable is non-interest bearing in this case and it would appear that it is not relevant to apply accruals based accounting per subdivision 45-C, however this is not clear.

We have relied on the balance sheet current/non-current classification, and applied that classification for the purpose of determining whether or not an amount must be paid within 12 months for the purpose of s. 6-40, Item 6. This may not be strictly accurate.

5. Prepayments

It appears that prepayments could be calculated with reference to s. 6-40 Item 3 of PDL. For this exercise, the tax value has been calculated as a depreciating asset in accordance with Division 40.

For comparative analysis, we have assumed the transitional rule contained in s 82KZMB would result in a taxable income adjustment.

6. Stock on Hand

The RBT draft legislation proposed that the valuation of stock be done at lower of cost or NRV (s. 38-20 of RBT). We have assumed that choice is available under the PDL (ie. market selling, replacement value or cost) until further provisions are released.

It is unclear how adjustments would be made for stock used by the taxpayer for private use. The reduction in the tax value of closing stock would result in a reduction in taxable income. We would anticipate an upward taxable income adjustment would be used to offset this reduction.

7. Leased Assets and Liabilities

Consistent with the current treatment of leased assets and liabilities, we understand that the TVM would aim to exclude the tax value of the leased assets and liabilities.

However, under the PDL, it is not entirely clear whether this is achieved by:

(a) excluding the asset from one being held by the taxpayer
(b) attributing a nil tax value to the asset
(c) treating the taxpayer as not having the liability
(d) attributing a nil value to the liability

Our findings, not reached without some difficulty, are:

- Prima facie – the lessee holds an asset being property which are rights to possession under the lease (s. 6-20, Item 1);

- Then, s. 6-21(1), Item 10 appears to indicate that the conclusion regarding s. 6-20 is overridden because the lessor holds the underlying asset. This would mean that the lessee does not hold an asset.

- However, s. 6-21(1), Item 10 requires the lessor to hold "the other asset because of an item in this table" (our emphasis). The lessor holds the underlying asset because of an item in the table to s. 6-20, not s. 6-21. It may be that Item 10 of s. 6-21(1) is limited to the luxury car lease situations.

- If rights under the lease are an asset held by a lessee, perhaps their taxable value is Nil by reference to s. 6-40, Item 9. Alternatively, s. 6-40, Item 1 may be relevant if these rights are "routine rights" - refer s. 6-45. This, however is by no means clear by reference to the PDL.

- On the liability side, prima facie, the lessee is under a present obligation to make lease payments.
  S. 7-23, Item 1 indicates that the lessee has a liability.

- However, it may be that s. 7-24, Item 4 overrides in this situation, if Item 10 of s. 6-21(1) is relevant (refer above).

- If there is a liability it is not clear to us how to calculate its taxable value under the PDL. Should the liability be a "routine liability" then its tax value would appear to be nil. However, again it is unclear as to how s 6 - 45 applies. For example most leases require payments on straight line basis whereas the benefit provided over the lease diminishes on a diminishing value basis.

The reason for outlining the above is to demonstrate our difficulty in applying the PDL to what are common transactions for SME's. In short, we believe we know what the answer should be, but have experienced difficulties in applying the PDL to achieve the correct outcome.

This area proved to be the single most difficult area for us in this case study.

8. Fixed Assets / Assets Under Hire Purchase

We note there are no accounting / tax depreciation differences in this case study. This will usually be the case for individual taxpayers who will typically use the tax depreciation rates.

For assets under hire-purchase, who "holds" the asset is determined under s. 6-21, Item 6 and clarification is provided by notes to that section.

9. Leasehold Improvements

We have treated the leasehold improvements as an asset held by the taxpayer, with a tax value calculated in accordance with Division 40.

It would appear there are two assets being the:

(a) property (being the leasehold improvement)
(b) leasehold rights the taxpayer holds under the lease

S. 6-21 Item 3 would suggest the lessee is the holder of the fixtures and fittings. Furthermore we have assumed no entity holds the leasehold rights due to s. 6-21 Item 11.

10. Trust Entitlements and Dividends

The worksheet calculation model incorrectly assumes that all trust distributions have been received. Typically an entitlement only will arise at year end to a distribution of trust income. It is not yet clear how to treat trust entitlements under TVM where there is a trust distribution with no amount being received by the taxpayer (ie. an unpaid trust entitlement).

Whilst an unpaid trust distributions is probably an "asset" as defined, in the absence of further analysis, it is not clear:

(a) whether the entitlement is a form of property held by the taxpayer;
(b) whether the entitlement is a right that is not property held by the taxpayer; or
(c) how to calculate the taxable value and "cost" of the entitlement.

Further issues to be considered will be determining the flow through of discount capital gains, dividend income and associated imputation credits, foreign income and associated foreign tax credits, etc.

We note that dividends receivable are "listed zero value" assets. However, we believe this replicates the tax treatment contained in s. 44 of the ITAA 1936 (ie. the taxing point being the time of payment by the company). We do not believe this treatment would be appropriate for trust entitlements.

11. Current and Non-Current Loans/Payables

In analysing the liabilities, we have interpreted "present legal or equitable obligation" as having the same meaning as incurred for the purposes of s. 8-1. This requires further investigation.

It appears that the tax value of current loans / payables may be different to non-current loans/payables. That is, it appears for liabilities that do not require payment within 12 months s. 7-75 Item 8 of PDL is relevant which then requires reference to Division 45 for the calculation of the tax value. We have relied on the balance sheet for the current / non-current classification.

For Hire Purchase Liabilities, Subdivision 45-C appears conceptually to provide the correct outcome. This is subject to our comments to Case Study 2, in which we have identified difficulties in applying Division 45. Depending on the accounting treatment adopted and the terms of the Hire Purchase contract, Subdivision 45-C may be difficult for many SME's to apply.

Where a discount or rebate is received on a payable, it is unclear how the amount would be treated. Our client currently returns these items as assessable income and reduces outstanding balance sheet liabilities. It is acknowledged that this accelerates assessable income and it would be more correct to reduce the "cost" of stock and the balance sheet closing balance for this item. These rebates relate to volume rebates and discounts associated with trading stock purchases. Where such rebates are received, we believe this would result in a decrease in the tax value of the liability (eg. under s. 7-75(1) Item 4 or 5). However, under TVM this appears to accelerate the recognition of income as we have not been able to identify how stock on hand is reduced under TVM unless Division 38 (not yet available) recognises a reduction in "cost" of stock.

In this case, the recipient of the discount or volume rebate receives a "credit" against his liability to the supplier of trading stock.

S. 8-27(3) indicates that if a liability decreases (otherwise than by the entity providing economic benefits pursuant to the liability), there is a non-cash benefit than one entity gives and another entity gets.

Assuming that the recipient of a volume rebate gets a non-cash benefit in that his liability to the supplier is reduced, then s. 8-29 is relevant. S. 8-29 indicates that the amount the recipient of a volume rebate is taken to "pay" for the benefit is equal to the total of the amounts that he is taken to "receive".

It would appear that Subdivision 8-B is then intended to apply to effectively bring the rebate to account as assessable, although rules for cash-like benefits are yet to be drafted. In this situation, it is not clear what if anything Division 8 adds to the calculation of Net Income as the movement in the "Tax Value" of the liability is recognised at s. 7-75.

12. Borrowing Costs

The deductible portion of the undeducted balance of borrowing costs (currently deducted under s. 25-25 of the ITAA 1997) has been adjusted for under the "taxable income adjustments". We have assumed this to be the appropriate treatment.

We understand the same outcome could have been achieved if the borrowing cost were treated as a depreciating asset under Division 40. As this type of expense would normally be an "off balance sheet" transaction (ie. typically borrowing costs are expensed for accounting purposes and are not normally recorded as assets in the balance sheet), it might not always be easily captured as a depreciating asset.

CASE 1 - INDIVIDUAL

MANAGEMENT REPORT
(Unaudited)

FOR THE YEAR ENDED

30 JUNE 2000

CASE 1 - INDIVIDUAL

STATEMENT OF OPERATIONS FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
Sales	20,261,990	18,837,897
Cost of goods sold		
Purchases	13,548,313	12,764,399
Gross profit	6,713,677 *33.1 %*	6,073,498 *32.2 %*
Selling and administration expenses (refer attached schedule)	9,137,367	8,132,008
	(2,423,690)	(2,058,510)
Other income		
Rent received	17,000	24,000
Discounts received	211,361	218,695
Profit on sale of investments	-	63,686
Rebates	148,319	115,764
Dividend received	18,221	13,036
Commissions	86	1,588
Sundry income	4,735	3,002
Interest received	2,421	7,279
Profit on disposal of fixed assets	-	388
	402,143	447,438
Operating loss	(2,021,547)	(1,611,072)
Retained profits at end	(2,021,547)	(1,611,072)

The statement of operations has been compiled without audit or review:
refer to compilation report and disclaimer.

PITCHER PARTNERS

CASE 1 - INDIVIDUAL

SCHEDULE TO STATEMENT OF OPERATIONS FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
Selling and administration expenses		
Advertising	8,040	-
Bad debts written off	318	5,714
Bank charges	100,172	47,709
Consultancy fees	3,305	-
Delivery expenses	3	-
Depreciation	24,044	30,856
Donations	408	-
Freight and cartage	348	-
Management fee	5,203,043	3,982,735
Hire of equipment	922	-
Health and beauty	92,299	-
Interest paid	263,246	283,342
Leased asset expenditure	72,097	9,935
Legal costs	1,053	2,452
Payroll tax	-	2,330
Photoprocessing cost	68,918	-
Printing and stationery	-	466
Repairs and maintenance	13,718	-
Provision for annual leave	4,108	-
Superannuation	-	438
Travelling expenses	594	-
Uniform	283	-
Wages	570,588	560,303
Pharmacy 1 expenses	-	702,993
Pharmacy 2 expenses	1,132,951	1,078,384
Pharmacy 3 expenses	1,576,909	1,424,351
	9,137,367	8,132,008

The statement of operations has been compiled without audit or review: refer to compilation report and disclaimer.

CASE 1 - INDIVIDUAL

BALANCE SHEET AT 30 JUNE 2000
(Unaudited)

	Note	2000 $	1999 $
CURRENT ASSETS			
Cash	2	6,940	7,440
Trade debtors	3	383,398	250,974
Sundry debtors	4	38,696	320,310
Loans receivable	6	705,467	332,608
Prepayments and other assets	7	88,284	92,278
Stock on hand	8	2,021,107	1,955,818
		3,243,892	2,959,428
NON-CURRENT ASSETS			
Land and Buildings	9	35,579	15,719
Plant and equipment	10	583,001	699,923
Investments	5	422,106	312,480
Loans receivable	6	5,336	-
Intangibles	11	2,101,485	2,101,485
		3,147,507	3,129,607
TOTAL ASSETS		6,391,399	6,089,035
CURRENT LIABILITIES			
Bank overdraft	12	494,855	165,948
Trade creditors and accruals	13	1,186,645	1,513,471
Loans payable	14	4,615,015	2,147,371
Lease liabilities	16	57,255	55,460
Hire purchase liabilities	17	6,067	5,333
Provisions - other	18	45,163	41,055
		6,405,000	3,928,638
NON-CURRENT LIABILITIES			
Lease liabilities	16	105,084	162,339
Hire purchase liabilities	17	16,011	22,079
Loans payable	14	5,745,086	5,834,214
		5,866,181	6,018,632
TOTAL LIABILITIES		12,271,181	9,947,270
NET LIABILITIES		(5,879,782)	(3,858,235)
PROPRIETOR'S EQUITY			
Current account	15	(5,879,782)	(3,858,235)
DEFICIENCY IN PROPRIETOR'S EQUITY		(5,879,782)	(3,858,235)

The balance sheet is to be read in conjunction with the notes to the financial statements and has been compiled without audit or review: refer to compilation report and disclaimer.

CASE 1 - INDIVIDUAL

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2000

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The significant policies which have been adopted in the preparation of these financial statements are:

Basis of Preparation

In the opinion of the proprietor, the business is not a reporting entity. The financial statements of the business have been drawn up as a special purpose financial report for use by the proprietor.

The financial statements have been prepared in accordance with all Australian Accounting Standards and other mandatory professional reporting requirements with the following exceptions:

AAS 22 Related Party Disclosures
AAS 28 Statement of Cash Flows
AAS 30 Accounting for Employee Entitlements
AAS 33 Presentation and Disclosure of Financial Instruments

	2000 $	1999 $
2. CASH		
Cash on hand	5,440	5,440
Petty cash	-	500
Cash on deposit	1,500	1,500
	6,940	7,440
3. TRADE DEBTORS		
Trade debtors	383,398	250,974
4. SUNDRY DEBTORS		
CURRENT		
Sundry debtors	7,628	-
Other debtors	31,068	320,310
	38,696	320,310

The notes to the financial statements have been compiled without audit
or review: refer to compilation report and disclaimer.

CASE 1 - INDIVIDUAL

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
5. INVESTMENTS		
NON-CURRENT		
Shares in other corporations, at cost		
Share No.1	263,618	223,601
Share No.2	72,379	46,879
Share No.4	9,000	6,000
Share No.5	7,127	7,048
Share No.6	28,977	17,952
Share No.7	1,000	1,000
Share No.8	10,000	10,000
Share No.9	5	-
Share No.10	30,000	-
	422,106	312,480
6. LOANS RECEIVABLE		
CURRENT		
Loans, unsecured		
Pharmacy 2	141,010	141,616
Loans, other	564,457	190,992
	705,467	332,608
NON-CURRENT		
Loans, unsecured		
Loans, Other	5,336	-
7. OTHER ASSETS		
CURRENT		
Prepayments	88,284	92,278

The notes to the financial statements have been compiled without audit or review: refer to compilation report and disclaimer.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
8. STOCK ON HAND		
CURRENT		
Stock on hand, at cost	2,021,107	1,955,818
9. LAND AND BUILDINGS		
Leasehold improvements	44,587	19,106
Less: Accumulated amortisation	(9,008)	(3,387)
	35,579	15,719
Total land and buildings, at WDV	35,579	15,719
10. PLANT AND EQUIPMENT		
Motor vehicles, at cost	57,170	57,170
Less: Accumulated depreciation	(29,469)	(22,017)
	27,701	35,153
Office furniture and equipment	60,583	60,583
Less: Accumulated depreciation	(51,530)	(49,078)
	9,053	11,505
Furniture and fittings	4,579	4,579
Less: Accumulated depreciation	(2,503)	(1,983)
	2,076	2,596
Furniture and fittings	91,884	91,884
Less: Accumulated depreciation	(39,048)	(25,428)
	52,836	66,456
Fixtures and fittings	219,446	185,719
Less: Accumulated depreciation	(56,617)	(28,866)
	162,829	156,853

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
10. PLANT AND EQUIPMENT (Continued)		
Plant and equipment under lease	267,630	267,630
Less: Accumulated depreciation	(121,472)	(55,451)
	146,158	212,179
Fixtures and fittings	271,603	262,787
Less: Accumulated depreciation	(89,255)	(47,606)
	182,348	215,181
Total plant and equipment, at WDV	583,001	699,923
11. INTANGIBLES		
Goodwill	2,399,986	2,399,986
Less: Accumulated amortisation	(343,501)	(343,501)
	2,056,485	2,056,485
Approval number	45,000	45,000
	2,101,485	2,101,485
12. BANK OVERDRAFT		
Bank overdraft	494,855	165,948
13. TRADE CREDITORS AND ACCRUALS		
Trade creditors	1,149,547	1,406,905
Sundry creditors	-	2,927
Other creditors	37,098	103,639
	1,186,645	1,513,471

CASE 1 - INDIVIDUAL

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
14. LOANS PAYABLE		
CURRENT		
Loans, unsecured		
Related Family Trust	4,285,347	1,827,590
Loans, other		47,140
Pharmacy 3	9,668	22,641
Loan, interstate pharmacy	320,000	250,000
	4,615,015	2,147,371
NON-CURRENT		
Loans, secured		
Pharmacy No.3	1,010,000	1,010,000
Bank	1,430,573	1,430,573
Bank	500,000	475,000
Bank	2,310,000	2,810,000
Bank	475,000	
Bank	19,513	27,071
Loans, unsecured		
Loans, Other		81,570
	5,745,086	5,834,214
15. CURRENT ACCOUNT		
Opening balance	(3,858,235)	(2,247,163)
Share of net loss	2,021,547	1,611,072
Closing balance	(5,879,782)	(3,858,235)
16. LEASE LIABILITIES		
Finance lease rentals are payable as follows:		
Due not later than one year	57,255	55,460
Due later than one year but not later than two years	105,084	162,339
Gross lease rentals	162,339	217,799
Net lease rentals	162,339	217,799
Amounts recognised in the accounts:		
Current	57,255	55,460
Non-current	105,084	162,339
Total lease liability	162,339	217,799

The notes to the financial statements have been compiled without audit or review: refer to compilation report and disclaimer.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
17. HIRE PURCHASE COMMITMENTS		
Hire purchase commitments		
Due not later than one year	6,067	5,333
Due later than one year but not later than two years	16,011	22,079
Minimum hire purchase payments	22,078	27,412
Amounts recognised in the accounts:		
Current	6,067	5,333
Non-current	16,011	22,079
Total hire purchase liability	22,078	27,412
18. OTHER PROVISIONS		
CURRENT		
Provision for employee entitlements	45,163	41,055

CASE 1 - INDIVIDUAL
TAX RECONCILIATION
CURRENT TAX SYSTEM

Accounting profit/(loss)			**(2,021,547)**
Add back / (less) timing differences (business)			
Provision for employee entitlements 2000	45,163		
Provision for employee entitlements 1999	(41,055)		
Prepayments 1999	68,518		
Prepayments 2000*	(46,722)		
Lease amortisation	66,026		
Lease finance charges	21,080		
Depreciation - accounting	160,916		
Depreciation - taxation	(160,916)		
Borrowing costs	(1,408)		
Lease payments	(76,540)		35,062
Add back / (less) other differences (non business)			
Tax distribution from Family Trust	2,449,384		
Tax distribution from Westpac	3,199		
Westpac Capital Gain received	941		
Non-deductible donations	74		
Capital gain from sale of shares & investment	-		
Prior yr capital losses applied	-		
Interest received on joint account - NAB	13		
Dividends received gross up amount	9,433		
Donation	(5,400)		
Profit on sale of shares & investment	-		
Bank charges on NAB account	(8)		
Bank charges on joint account - Commonwealth	-		2,457,635
Taxable income/(loss)			**471,150**
Carried forward losses		1997	(82,020)
		1998	(695,618)
		1999	(502,605)
		2000	471,150
			(809,093)

Notes

*** Prepayments - deductible**	**Total**	**@80%**
Interest - Number 1	46,440	37,152
Interest - Number 2	11,963	9,570
Total Deductible Prepayments	**58,403**	**46,722**

CASE STUDY 2 - PARTNERSHIP

1. Background

Case Study 2 considers a professional legal practice of almost 40 partners. In the year under review there was significant change in partnership members. As a result of a "merger" a relatively large number of partners were either admitted or resigned from the partnership.

In addition, the partnership changed its method of accounting, so as to recognise taxation timing differences (the largest single item being WIP) against partners current accounts.

Like most professional partnerships Work-in-Progress (WIP) is recognised for accounting purposes. This item comprised the partnership's largest single accounting/tax difference.

2. Key Findings

Is the correct answer achieved?

It would appear that the legislation requires further development to ensure that the correct answer is achieved in the situation considered.

Particular areas of difficulty noted where:

- Movement in partnership current accounts and distributions of partnership profits/loss; and
- Non-current financial assets and liabilities and how to apply Division 45, if relevant.

Difficulties/Ease of Application

- The major areas of difficulties are noted immediately above. Please refer to the notes and assumptions to our Working Schedule for further detail.

Availability of Data

- Available data comprised the set of financial statements attached. Although information concerning Receipts and Payments was not available, this did not present difficulties in itself.

TAXABLE INCOME OVERVIEW

CASE 2 - PROFESSIONAL PARTNERSHIP
METHOD 1 - PROFIT RECONCILIATION METHOD

Operating Profit / (Loss) before Tax	2,684,356
Excess of Movement in Tax Values over Account Values - See Schedule	(1,941,408)
Net Income	**742,948**
Taxable Income Adjustments - See Schedule	101,533
Unused Tax Losses - See Schedule	-
Total	**844,481**

CASE 2 - PROFESSIONAL PARTNERSHIP
METHOD 2 - BALANCE SHEET METHOD

Receipts Less Payments (Business) - See Schedule	(707,351)
Net Change in Tax Values of Assets and Liabilities - See Schedule	1,450,299
Net Income	**742,948**
Taxable Income Adjustment - See Schedule	101,533
Unused Tax Losses	-
Total	**844,481**

PITCHER PARTNERS

CASE 2 - PARTNERSHIP
WORKING SCHEDULE

Taxable Income - 5-15	Notes	Section	Accounts Opening Value	Accounts Closing Value	Accounts Movement	Tax Opening Value	Tax Closing Value	Tax Movement	Profit Rec Method Excess of Tax Over Accounts	Receipts/ Payments (Business)	Receipts/ Payments (Non Business)	Balance Sheet Method Movement in Tax Values	Taxable Income Adj'ment	Unused Tax Losses	Total
Current Assets					-			-							-
Petty Cash		5-55, 5-60	6,340	12,500	6,160	6,340	12,500	6,160	-	6,160		-			6,160
Trade Debtors		6-40 Item 6	3,033,122	4,715,527	1,682,405	3,033,122	4,715,527	1,682,405				1,682,405			1,682,405
Provision for Doubtful Debts	5		(43,581)	(205,107)	(161,526)	-	-	-	161,526			-			-
Other Debtors		6-40 Item 6	109,242	1,678	(107,564)	109,242	1,678	(107,564)	-			(107,564)			(107,564)
Prepayments		6-40 Item 3	80,532	37,377	(43,155)	80,532	37,377	(43,155)	-			(43,155)			(43,155)
Other Assets		6-40 Item 9	-	41,694	41,694	-	41,694	41,694	-			41,694			41,694
Work in progress	1	6-40(3)(e)	1,886,310	4,007,174	2,120,864	-	-	-	(2,120,864)						-
Unbilled Disbursements	2		211,216	569,666	358,450	-	-	-	(358,450)						-
Provision for Non-recoverable Work in Progress	3	7-23, Item 1	-	(258,302)	(258,302)	-	-	-	258,302						-
Loans Receivable					-			-				-			-
Loans Receivable - Non Current		6-40 Item 7, 45-15	785,639	758,846	(26,793)	785,639	758,846	(26,793)	-			(26,793)			(26,793)
Current Liabilities					-			-	-			-			-
Bank overdraft		5-55, 5-60	(160,973)	(874,484)	(713,511)	(160,973)	(874,484)	(713,511)	-	(713,511)					(713,511)
Trade Creditors		7-75(1) Item 5	(468,193)	(652,428)	(184,235)	(468,193)	(652,428)	(184,235)	-			(184,235)			(184,235)
Sundry Creditors		7-75(1) Item 5	(84,959)	(332,933)	(247,974)	(84,959)	(332,933)	(247,974)	-			(247,974)			(247,974)
Other Creditors		7-75(1) Item 5	-	(143,872)	(143,872)	-	(143,872)	(143,872)	-			(143,872)			(143,872)
Accrued Expenses - Superannuation	6		(26,725)	(4,981)	21,744	(26,725)	(4,981)	21,744	-			21,744			21,744
Loans Payable					-			-	-			-			-
Loans Payable - Bank - Non Current	7	7-75(1) Item 8	-	(24,859)	(24,859)	-	(24,859)	(24,859)	-			(24,859)			(24,859)
Loans Payable - Bank - Non Current	7	7-75(1) Item 5	(2,300,000)	(2,580,000)	(280,000)	(2,300,000)	(2,580,000)	(280,000)	-			(280,000)			(280,000)
Loans Payable - Other - Non Current	7	7-75(1) Item 8	(1,933,240)	(4,377,749)	(2,444,509)	(1,933,240)	(4,377,749)	(2,444,509)	-			(2,444,509)			(2,444,509)
Provisions					-			-	-			-			-
Provision for Annual Leave	4		(110,128)	(221,443)	(111,315)	-	-	-	111,315			-			-
Provision for Long Service Leave	4		(30,263)	(37,021)	(6,758)	-	-	-	6,758			-			-
Equity					-			-	-			-			-
Capital Account	8	7-75, item 6	(210,000)	(455,000)	(245,000)	(210,000)	(455,000)	(245,000)	-			(245,000)			(245,000)
Current Account - Opening Balance	8	7-75, item 6	(744,339)	(744,339)	-	(744,339)	(744,339)	-	-			-			-
Current Account - Capital introduced	8			(773,578)	(773,578)		(773,578)	(773,578)	-			(773,578)			(773,578)
Current Account - Profit distributed	8								-			-			-
Current Account - Drawings	8			2,880,575	2,880,575		2,880,575	2,880,575	-			2,880,575			2,880,575
Current Account - Other	8			1,345,420	1,345,420		1,345,420	1,345,420	-			1,345,420			1,345,420
Current Account - Provision for Tax	8			1,790,125	1,790,125				(1,790,125)			-			-
Reserves	9			(1,790,130)	(1,790,130)				1,790,130			-			-
Net Income			-	2,684,356	2,684,356	(1,913,554)	(1,170,606)	742,948	(1,941,408)	(707,351)	-	1,450,299	-	-	742,948
Income Tax Adjustments					-			-	-			-			-
Prepayments		*82KZMB ITAA 1936*			-			-	-			-	50,630		50,630
Non-Allowable Entertainment Expenses		5-100 Item 9			-			-	-			-	51,127		51,127
Non Allowable Membership Fees		Private			-			-	-			-	1,520		1,520
Non Allowable Leave Payments		Private			-			-	-			-	20,000		20,000
Superannuation Paid		*82AAC*			-			-	-			-	(21,744)		(21,744)
Tax Losses					-			-	-			-			-
Total Taxable Income			-	2,684,356	2,684,356	(1,913,554)	(1,170,606)	742,948	(1,941,408)	(707,351)	-	1,450,299	101,533	-	844,481

CASE 2 - PARTNERSHIP
NOTES AND ASSUMPTIONS

Case studies should be reviewed sequentially. Notes and assumptions common to both this case study and Case Study 1 are noted following Case Study 1 only. Only additional issues relevant to Case Study 2 are noted here.

1. Work In Progress ("WIP")

The treatment of work in progress ("WIP") is not completely clear under the TVM. As WIP embodies future economic benefits, we have firstly characterised the item as an asset in accordance with s. 6-15 of the Prototype Draft Legislation ("PDL").

For the purposes of s. 6-20, it is questionable whether, at the time WIP is recognised for accounting purposes, that there is "property" or a "legal or equitable right". However, assuming WIP is either property or a right, and therefore the taxpayer holds an asset, we have attributed the WIP with a "zero tax value". This is subject to the definition of "non-billable WIP" in s. 6-40(3)(e) of PDL.

If the WIP was instead "billable", this could result in a tax value equal to cost, under s. 6-40 Item 9. This would not appear to be the correct result. "Billable" might be taken on an initial reading of PDL to mean WIP capable of being billed. Perhaps the use of the term "non-billed" work-in-progress might provide clarity.

2. Unbilled Disbursements

Disbursements are incurred as clients' legal matters are in progress.

At year end the partnership claims a tax deduction for disbursements on the basis that it has incurred them. For accounting purposes disbursements are "capitalised" and recognised as an asset in the balance sheet until such outgoings are recovered from the client or written off, if recovery is not possible. This may occur in cases where clients are charged on a success fee basis. That is, recovery of the disbursement may be contingent.

The correct analysis appears to be that pursuant to s. 6-18(3) two sets of rights may arise being:

- Rights to the provision of benefits derived by incurring the disbursement (eg barristers opinion, courier services etc); and
- Rights to recovery of disbursement (upon the happening of a contingency).

However, until the contingency is met the second set of rights do not arise - refer s. 6-18(4).

At year-end the relevant contingencies are not met and it becomes relevant to determine who "holds" an asset, if any, by reason of incurring the disbursement.

It is assumed that the disbursement is, say, for courier services or barrister fees, no asset is "held" and effectively a deduction is allowed for the disbursement under TVM.

3. Provision for Non Recoverable WIP

The provision (not being a present obligation and hence a liability that the taxpayer has under s. 7-23) has been excluded from the tax calculations.

4. Provision for Employee Entitlements

We have interpreted a present legal or equitable obligation similarly to the interpretation of "incurred". This is consistent with the TVM EM June 2001, at para 8.35. Thus, the partnership does not "have" a liability pursuant to s. 7-23 Item 1.

5. Provision for Doubtful Debts

Again, we have interpreted a present legal or equitable obligation similarly to the interpretation of "incurred". Thus, the partnership does not "have" a liability pursuant to s. 7-23 Item 1.

We note that when the debts are actually written off, this would result in an adjusted tax value to the receivable balance, effectively resulting in a bad debt deduction. We expect that this would be clarified with a rule similar to that contained in s. 25-35 of the ITAA 1997, which would provide for an income tax adjustment where non-money lending taxpayers who wrote off debts did not originally return the debt as assessable income.

Where the accounts disclose a receivables balance net of the provision for doubtful debts, the movement in this balance would result in doubtful debts being effectively "claimed" prior to them being written off, if not properly investigated.

6. Accrued Expenses

Relates to superannuation not "paid" by year end. Whilst a liability to make superannuation contributions on behalf of employees arose prior to year-end, this item has been treated as an income tax adjustment in that s. 82AAC, 1936 ITAA, requires the payment to be "made" in the year of income.

7. Non-current Liabilities

Non-current liabilities comprise amounts owing to former partners, commercial bill debt and other interest bearing bank loans.

To determine the taxable value of the non-current liabilities it appears relevant to refer to Division 45 - refer to s. 7-75(1), Item 8.

It was not however not immediately clear to us whether Item 1 or Item 2 of s. 45-40 applied. That is, Item 1 only applies if Item 2 does not. Similarly Item 2 only applies to any other financial liabilities that Item 1 does not apply to. To remedy this issue, we suggest that paragraph (b) to Item 1 might be deleted.

It has been assumed that amounts owing to former partners are accounted for on a realisation basis - Item 2, s. 45-40 treatment. Our Working Schedule also adopts this treatment for taxation purposes. However, is such loans are certain of repayment (regardless of when they may be repaid) and are interest free, then applying subdivision 45-C appears to provide an identical result. It is submitted however, that if interest free loans are certain of repayment, it is confusing to calculate taxable value under subdivision 45-C which prima facie adopts an accruals basis.

Typically, commercial bills are rolled over every 90 days under facilities that allow maximum amounts to be drawn down on an ongoing basis.

As such commercial bill borrowings have been recorded for accounting purposes as non-current liabilities.

However, if bills are rolled over every 90 days, then on a bill by bill basis, s. 7-75(1), Item 5 appears to be relevant as each financial liability (each bill) must be paid within 12 months.

The balance sheet also shows other long term debt, which are interest bearing bank loans.

Difficulties faced in applying Division 45 (assuming s. 7-75(1), Item 8 is relevant) are:

- It is not clear whether Item 1 or 2 of s. 45-40 is relevant (refer above); and
- For part year loans, s. 45-75(4) appears to increase rather than decrease "interest %".

For example, a $100 loan at 10% taken out on 1 January 2001, should accrue $5 interest to year end of 30 June 2001. Assuming no repayments the taxable value at 30 June 2001 might be expected to be $105, ($100 loan plus $5 interest).

However, s. 45-75(1) and (4) appear to give the following result

[Last tax value x (1 + Interest %)] - Cash flows at the test time

[$100 x (1 + (10% x 365/181)] - $Nil

[$100 x 1.2] - $Nil

$120 = Taxable Value

It would appear that the dominator and numerator in s. 45-75(4) need to be reversed.

In light of these difficulties balance sheet figures (which are representative of the outcomes achieved by Items 4 or 5 of s. 7-75(1)) have been adopted.

8. Capital of the Partnership

Due to limited rules currently available on capital, obtaining the correct result was a significantly difficult exercise.

The PDL currently allows for a company's paid up share capital (PUC) to constitute a liability (s. 7-24 Item 1 of PDL). The amount of the liability would be the amount of PUC (s. 7-75(1) Item 6 of PDL). Using this concept, we believe the partnership current and capital account would also be considered a liability.

During the year the partners introduced capital to the partnership capital account of $245,000. This amount has been treated as the increase in the taxable value of a liability of PUC, per the Working Schedule.

However, with a partnership, the profits are distributed and recorded in the current account. The current account is also used to record drawings and other movements related to partnership capital.

For the purpose of the TVM calculation, the current account has been recorded as a liability, with a tax value equal to the amount of the movement in the account. For the purposes of illustration only, the Working Schedule shows on an aggregate basis all movements in the current account. The distribution of profits (and the creation of a reserve, which is discussed below) are the only entries that have been allocated a nil value. Although this provides the correct answer, it is questionable whether this treatment is correct or is intended under the TVM.

9. Reserves

A reserve, being a provision for tax timing differences, was raised during the 30 June 2000 year of income. The reserve would result in (a) a reduction in the current account and (b) an increase in the partnership reserve account.

The provision for Tax Adjustments was taken up to reflect each partner's proportionate share of the taxation timing differences that will reverse on cessation of the partnership. For example, if the partnership was to cease to exist at 30 June 2000, the subsequent tax return would not show any book profit but there would be an add back for taxation purposes in relation to WIP. The provision for tax is a book entry only, aimed at informing partners of their net (after tax) partnership current account balance.

This provision does not impact on the calculation of taxable income under existing law. As this provision also does not impact on the profit and loss statement, no accounting/tax adjustment is required under current legislation.

Such a provision, even if it is a liability under PDL, is not a liability that anyone "has" – refer to s 7-23, Item 1.

The relevant adjustments on the Working Schedule indicate that care will need to be taken where provisions impact on the balance sheet only.

CASE 2 - PARTNERSHIP

MANAGEMENT REPORT
(Unaudited)

FOR THE YEAR ENDED

30 JUNE 2000

CASE 2 - PARTNERSHIP

STATEMENT OF OPERATIONS FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
INCOME		
Fees	2,738,125	547
Fees rendered	20,331,081	11,671,276
Work in progress movement	1,862,562	-
Insurance claims	15,651	114,002
Sundry income	46,971	15,391
Interest received	8,176	9,715
Capital gain on disposal of fixed assets	-	6,880
Total income	25,002,566	11,817,811
EXPENSES		
Expenses per schedule	22,318,206	9,680,050
Total expenses	22,318,206	9,680,050
Operating profit	2,684,360	2,137,761

The statement of operations has been compiled without audit or review:
refer to compilation report and disclaimer.

CASE 2 - PARTNERSHIP

	2000 $	1999 $
Distributions to Partners		
Partner No.1	63,879	-
Partner No.2	88,276	-
Partner No.3	63,879	-
Partner No.4	40,000	-
Partner No.6	63,879	-
Partner No.7	60,000	-
Partner No.8	63,879	-
Partner No.9	63,879	-
Partner No.10	124,560	-
Partner No.11	63,879	-
Partner No.12	127,759	194,266
Partner No.13	244,871	493,533
Partner No.14	-	36,000
Partner No.15	22,006	22,006
Partner No.18	63,879	123,383
Partner No.19	63,879	123,383
Partner No.20	63,879	123,383
Partner No.21	63,879	123,383
Partner No.22	201,570	124,743
Partner No.23	63,879	123,383
Partner No.24	140,000	140,000
Partner No.25	126,667	113,000
Partner No.26	126,667	110,000
Partner No.27	126,667	112,000
Partner No.28	101,940	140,000
Partner No.29	62,500	-
Partner No.30	46,620	-
Partner No.31	48,370	-
Partner No.32	52,604	-
Partner No.33	62,500	-
Partner No.34	51,620	-
Partner No.38	35,294	35,294
Partner No.39	53,370	-
Partner No.40	37,826	-
	2,684,356	2,137,757

CASE 2 - PARTNERSHIP

	2000 $	1999 $
SCHEDULE OF EXPENSES		
Advertising	17,863	8,702
Doubtful debts	91,526	50,004
Bad debts written off	194,169	(3,000)
Bank charges	237,356	70,895
Conference expenses	46,952	3,160
Consultancy fees	-	87,017
Disbursements written off	165,028	(176,267)
Delivery expenses	-	5,390
Donations	-	70
Electricity	-	30,546
Entertainment expenses	102,254	116,433
Filing fees	263,971	-
Firm events	21,314	-
Fringe benefits tax	12,640	29,302
General expenses	8,742	13,316
Indemnity insurance	251,017	137,670
Insurance	82,805	40,343
Interest paid	353,035	174,672
Other expenses	-	-
Rental expenditure	-	576,240
Legal costs	-	96,458
Law institute fees	87,898	-
Long service leave paid	-	-
Management fees	15,167,367	4,238,725
Marketing - general	230,658	149,621
Motor vehicle expenses	-	12,069
Merger costs	-	10,924
Payroll tax	232,420	71,084
Car parking	118,358	57,352
Postage	-	51,086
Printing and stationery	-	159,509
Professional fees	67,567	34,495
Professional association subscriptions	23,962	11,130
Staff recruitment	110,569	-
Registration fees	1,518	-
Rent	-	1,365,488
Repairs and maintenance	-	47,717
Salaries and wages	3,746,822	1,516,155
Temporary staff	41,945	8,045
Service agreements	-	74
Staff training	61,095	76,812
Staff Amenities	93,852	33,281
Storage fees	-	42,503
Subscriptions	95,090	203,282
Superannuation contributions	259,863	115,418
Telephone	-	145,288
Travelling expenses	108,601	62,278
Workcover	21,949	6,763
Total expenses	22,318,206	9,680,050

The statement of operations has been compiled without audit or review:
refer to compilation report and disclaimer.

CASE 2 - PARTNERSHIP

BALANCE SHEET AT 30 JUNE 2000
(Unaudited)

	Note	2000 $	1999 $
CURRENT ASSETS			
Cash	2	12,500	6,340
Trade debtors net of provision for doubtful debts	3	4,510,420	2,989,541
Sundry debtors	4	1,678	109,242
Prepayments and other assets	6	79,071	80,532
Stock on hand	7	4,318,538	2,097,526
		8,922,207	5,283,181
NON-CURRENT ASSETS			
Loans receivable	5	758,846	785,639
		758,846	785,639
TOTAL ASSETS		9,681,053	6,068,820
CURRENT LIABILITIES			
Bank overdraft	8	874,484	160,973
Trade creditors and accruals	9	1,134,214	579,877
Provision for employee entitlements	14	258,464	140,391
		2,267,162	881,241
NON-CURRENT LIABILITIES			
Creditors and borrowings	13	2,580,000	2,300,000
Loans payable	10	4,402,608	1,933,240
		6,982,608	4,233,240
TOTAL LIABILITIES		9,249,770	5,114,481
NET ASSETS		431,283	954,339
PARTNERS' EQUITY			
Capital accounts		455,000	210,000
Current accounts		(1,813,847)	744,339
Reserves	15	1,790,130	-
TOTAL PARTNERS' EQUITY		431,283	954,339

The balance sheet is to be read in conjunction with the notes to the financial statements and has been compiled without audit or review: refer to compilation report and disclaimer.

CASE 2 - PARTNERSHIP

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2000

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The significant policies which have been adopted in the preparation of these financial statements are:

Basis of Preparation

In the opinion of the partners, the partnership is not a reporting entity. The financial statements of the partnership have been drawn up as a special purpose financial report for use by the partners.

The financial statements have been prepared in accordance with all Australian Accounting Standards and other mandatory professional reporting requirements with the following exceptions:

AAS 22 Related Party Disclosures
AAS 28 Statement of Cash Flows
AAS 30 Accounting for Employee Entitlements
AAS 33 Presentation and Disclosure of Financial Instruments

	2000 $	1999 $
2. CASH		
Petty cash items	12,500	6,340
3. TRADE DEBTORS		
Trade debtors	4,715,527	3,033,122
Less: Provision for doubtful debts	(205,107)	(43,581)
	4,510,420	2,989,541
4. SUNDRY DEBTORS		
CURRENT		
Other debtors	1,678	109,242
5. LOANS RECEIVABLE		
NON-CURRENT		
Loans, unsecured		
Partners loan	2,234	3,234
Partners loan	54,426	67,233
Partners loan	1,353	-
Partners loan	101,567	115,906
Loans, other	243,220	243,220
Loans, other	356,046	356,046
	758,846	785,639

The notes to the financial statements have been compiled without audit or review: refer to compilation report and disclaimer.

CASE 2 - PARTNERSHIP

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
6. OTHER ASSETS		
CURRENT		
Other assets	41,694	-
Prepayments	37,377	80,532
	79,071	80,532
7. STOCK ON HAND		
CURRENT		
Work in progress	4,007,174	1,886,310
Unbilled disbursements	569,666	211,216
Provision for non-recoverable work in progress	(258,302)	-
	4,318,538	2,097,526
8. BANK OVERDRAFT		
Bank overdraft	874,484	160,973
9. TRADE CREDITORS AND ACCRUALS		
Trade creditors	652,428	468,193
Sundry creditors	332,933	84,959
Creditors clearing accounts	148,853	26,725
	1,134,214	579,877
10. LOANS PAYABLE		
NON-CURRENT		
Loans, unsecured		
Business loan	24,859	
Loan re payout	114,333	
Loans, other	3,688,039	1,713,240
Loans, related corporations		
Investment - Number 1	110,000	110,000
Investment - Number 2	110,000	110,000
Liabilities to former partners		
Former Partner 1	54,941	
Former Partner 2	102,388	
Former Partner 3	104,096	
Former Partner 4	93,952	
	4,402,608	1,933,240

The notes to the financial statements have been compiled without audit or review: refer to compilation report and disclaimer.

CASE 2 - PARTNERSHIP

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
11. CAPITAL ACCOUNTS		
Total capital accounts	455,000	210,000
12. CURRENT ACCOUNTS		
Opening balance	744,339	488,434
Capital introduced	773,578	-
Profit distributed	2,684,356	2,137,757
Drawings	(2,880,575)	(2,940,652)
Other	(1,345,420)	1,058,800
Provision for tax	(1,790,125)	-
Closing balance	(1,813,847)	744,339
13. OTHER CREDITORS		
NON-CURRENT		
Bank	2,580,000	2,300,000
14. PROVISIONS FOR EMPLOYEE ENTITLEMENTS		
CURRENT		
Provision for annual leave	221,443	110,128
Provision for long service leave	37,021	30,263
	258,464	140,391
15. RESERVES		
Tax reserve	1,790,130	-
Movements during the year consist of:		
Tax reserve		
Balance at beginning of year	-	-
Movement for the year	1,790,130	-
Balance at end of year	1,790,130	-

The notes to the financial statements have been compiled without audit or review: refer to compilation report and disclaimer.

CASE 2 - PARTNERSHIP
TAX RECONCILIATION
CURRENT TAX SYSTEM

Accounting profit/(loss)		**2,684,360**
Add back timing differences		
Annual leave provision - 2000	221,443	
Long service leave provision - 2000	37,021	
Doubtful debts provision - 2000	205,107	
Work in progress - 1999	1,886,310	
Unbilled disbursements - 1999	211,216	
Prepayments - 1999	80,532	
Entertainment expenses	51,127	
Club membership	1,520	
Sabbatical payments	20,000	
Accrued superannuation - 2000	4,981	2,719,257
Less timing differences		
Annual leave provision - 1999	(110,128)	
Long service leave provision - 1999	(30,263)	
Doubtful debts provision - 1999	(43,581)	
Work in progress - 2000	(3,748,872)	
Unbilled disbursements - 2000	(569,666)	
Prepayments - 2000 (@ 80%)	(29,902)	
Superannuation accrual - 1999	(26,725)	(4,559,137)
Taxable income/(loss)		**844,480**

CASE STUDY 3 - TRUST

1. Background

The trust, which is a unit trust, provides management services to a number of related entities involved in the retirement village industry.

The trust carries on an active business, and was chosen for testing as an entity with turnover in the range of $1m to $5m.

2. Key Findings

Is the correct answer achieved?

Subject to further legislation being released on issues specific to trusts, and provisions relating to non-current assets being clarified the correct outcome was achieved.

Difficulties/Ease of Application

This case study was relatively straight forward other than in the areas of:

- Determining the taxable value of trust entitlements and beneficiary's entitlements; and
- Determining how, and if, Division 45 applies to certain non-current financial assets.

Both the issues noted above are common to more than one case study and are noted in more detail in notes following each case study.

A further issue relevant to trusts is to ultimately determine the correct treatment for trust income distributed to beneficiaries.

No other difficulties arose in this case study.

Availability of Data

Data attached comprises a set of financial statements for the trust. No other data was required to apply the PDL and we found it was not necessary to have details of all "Receipts and Payments" of the business.

TAXABLE INCOME OVERVIEW

CASE 3 - TRUST
METHOD 1 - PROFIT RECONCILIATION METHOD

Operating Profit / (Loss) before Tax	475,075
Excess of Movement in Tax Values over Account Values - See Schedule	11,089
Net Income	**486,164**
Taxable Income Adjustments - See Schedule	2,652
Unused Tax Losses - See Schedule	-
Total	**488,816**

CASE 3 - TRUST
METHOD 2 - BALANCE SHEET METHOD

Receipts Less Payments (Business) - See Schedule	2,207,784
Net Change in Tax Values of Assets and Liabilities - See Schedule	(1,721,620)
Net Income	**486,164**
Taxable Income Adjustment - See Schedule	2,652
Unused Tax Losses	-
Total	**488,816**

CASE 3 - TRUST
WORKING SCHEDULE

Taxable Income - 5-15	Notes	Section	Accounts Opening Value	Accounts Closing Value	Accounts Movement	Tax Opening Value	Tax Closing Value	Tax Movement	Profit Rec Method Excess of Tax Over Accounts	Receipts/ Payments (Business)	Receipts/ Payments (Non Business)	Balance Sheet Method Movement in Tax Values	Taxable Income Adj'ment	Unused Tax Losses	Total
Current Assets					-			-	-						
Cash at Bank		5-55, 5-60	548,393	2,755,264	2,206,871	548,393	2,755,264	2,206,871	-	2,206,871					2,206,871
Cash held in trust		5-55, 5-60	20	20	-	20	20	-	-	-					-
Sundry Debtors		6-40 Item 6	-	913	913	-	913	913	-	913					913
Receivable					-			-	-			-			-
Security Deposits		6-40 Item 6	4,150	4,150	-	4,150	4,150	-	-			-			-
Loans Receivable					-			-	-			-			-
Loans Receivable - Current		6-40 Item 6	18,055,663	10,908,231	(7,147,432)	18,055,663	10,908,231	(7,147,432)	-			(7,147,432)			(7,147,432)
Trust Entitlements - Current	1		4,715,728	4,715,728	-	4,715,728	4,715,728	-	-			-			-
Loans Receivable - Non Current	2	6-40 Item 7	1,859,418	1,859,418	-	1,859,418	1,859,418	-	-			-			-
Fixed Assets (Held by Taxpayer)					-			-	-			-			-
Motor vehicles (Cost less decline)		40-35	55,214	24,775	(30,439)	55,214	24,775	(30,439)	-			(30,439)			(30,439)
Fixture, fittings & equipment (Cost less decline)	3	40-35	36,683	121,884	85,201	36,683	128,855	92,172	6,971			92,172			92,172
Other Assets					-			-	-			-			-
IT Project	4	40-35	20,914	58,739	37,825	20,914	58,739	37,825	-			37,825			37,825
Current Liabilities					-			-	-			-			-
Trade Creditors		7-75(1) Item 5	(27,082)	(96,259)	(69,177)	(27,082)	(96,259)	(69,177)	-			(69,177)			(69,177)
Sundry Creditors		7-75(1) Item 5	(33,953)	(60,450)	(26,497)	(33,953)	(60,450)	(26,497)	-			(26,497)			(26,497)
Loans Payable					-			-	-			-			-
Loans Payable - Current		7-75(1) Item 5	(9,404,944)	(3,983,016)	5,421,928	(9,404,944)	(3,983,016)	5,421,928	-			5,421,928			5,421,928
Beneficiary Entitlements - Current	1		(2,157,087)	(2,632,162)	(475,075)	(2,157,087)	(2,632,162)	(475,075)	-			(475,075)			(475,075)
Provisions					-			-	-			-			-
Employee Entitlements		7-23 Item 1	(25,968)	(30,086)	(4,118)	-	-	-	4,118			-			-
Equity					-			-	-			-			-
Settled Sum	5		(20)	(20)	-	(20)	(20)	-	-			-			-
Issued Units	5		(20)	(20)	-	(20)	(20)	-	-			-			-
Accumulated Income	5		(13,647,109)	(13,647,109)	-	(13,647,109)	(13,647,109)	-	-			-			-
Distribution	5		-	475,075	475,075		475,075	475,075	-			475,075			475,075
Net Income			-	475,075	475,075	25,968	512,132	486,164	11,089	2,207,784	-	(1,721,620)	-	-	486,164
Income Tax Adjustments					-			-	-			-			-
Non-Allowable Entertainment Expenses		5-100 Item 9			-			-	-			-	2,652		2,652
Blackhole Expenditure	6				-			-	-			-			-
Tax Losses					-			-	-			-			-
Total Taxable Income			-	475,075	475,075	25,968	512,132	486,164	11,089	2,207,784	-	(1,721,620)	2,652	-	488,816

CASE 3 - TRUST
NOTES AND ASSUMPTIONS

Case studies should be reviewed sequentially. Notes and assumptions common to both this case study and earlier case studies are noted in earlier case studies. Only additional issues relevant to case are noted here.

1. Trust Entitlement and Beneficiary Entitlement Account

Issues in relation to "trust entitlements" were discussed in Case Study 1 (the individual). This issue is also relevant in this case.

Furthermore, the treatment of unpaid distributions, or "beneficiary entitlements" is also yet to be determined under PDL.

In order to calculate the correct taxable income, this item must either have a taxable value (approach adopted) or an Income Tax Adjustment might be made. However, a fundamental issue is whether the entitlement is treated as a "liability" of the trust, or whether the amount is recognised as being held on separate trust for the beneficiary.

We believe this issue could be resolved by drafting a similar provision to that of s. 7-20(2) of the PDL for trusts. We note, if the item is determined to be a liability, that a rule similar to s. 7-24 Item 1 for the entitlement would provide a tax value of the liability. For the purpose of our calculation, we have assumed this treatment.

2. Loans Receivable – Non-current

S. 6-40 Item 7 refers to Division 45 for determination of the taxable value of this item.

Again significant difficulties were faced with determining whether Item 1 or Item 2 of s. 45-15 was relevant.

Again it appears that as "Book Value" provided the correct tax outcome this was adopted for "Tax Value".

3. Tax Value of Depreciating Assets

The "Tax Value" of the depreciating assets, calculated in accordance with Division 40 of the PDL, was different to the accounting written down value. In this case, relevant "Book Value" depreciation information was available, the "Tax Value" of the assets was not readily available. This required us to perform a reconciliation of the opening and closing "Tax Value" balances to "Book Value" balances to check that we achieved the correct result. Although our example was relatively straight forward this area may result in an increase in compliance costs where reconciliations are not currently undertaken. Whilst best practice would dictate that taxpayers should reconcile accounting/tax depreciation schedules (where they differ) many SME's may not do so.

4. IT Projects

The IT Projects comprises of capitalised consultants costs. At this stage, a taxation deduction has not been claimed under the current system. Upon finalisation of the project it is anticipated that the end result will be software, which will be treated as a depreciating asset.

5. Equity of the Trust

"Trust Capital" comprising of the Settled Sum, Issued Units and Accumulated Income, has been treated essentially as Paid Up Capital for a company – refer to s. 7-24(1) Items 1 and 2, and s. 7-75 Items 6 and 7.

In order to calculate taxable income of the trust, an adjustment is required for the distribution that has been made from the trust. This can be done by either attaching a tax value to the distribution (where the amount would be recorded as a positive amount) or by allowing for a tax adjustment of the accounting distribution. We have simply made the adjustment.

6. Blackhole Expenditure

Pre-acquisition costs of $2,667 were written back under existing legislation. Assuming that under the TVM there would not be a write back of this amount, a difference of $2,667 arises.

7. Interest Receivable

Interest was included in income. In this case interest had been received in the sense that it was credited to a money account. In the event that there was a receivable for interest taken up for accounting purposes, the amount would appear to be an asset that is "held" and hence the TVM would tax an accrued interest amount. If this is correct perhaps such an asset needs to be recognised as a "listed zero tax value asset".

CASE 3 - TRUST

MANAGEMENT REPORT
(Unaudited)

FOR THE YEAR ENDED

30 JUNE 2000

CASE 3 - TRUST

STATEMENT OF OPERATIONS FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
INCOME		
Management fees	1,325,920	922,546
Sundry income	7,561	7,354
Interest received	725,584	2,630,893
Total income	2,059,065	3,560,793
EXPENSES		
Acquisition investigation costs	2,667	19,534
Audit fees	1,550	-
Bank charges	15,406	15,312
Cleaning	4,115	2,720
Consultancy fees	114,648	11,280
Courier expenses	1,567	2,333
Data processing charges	-	2,927
Depreciation	66,991	26,777
Electricity	2,843	3,019
Entertainment	8,147	5,757
Fringe benefits tax	24,929	28,636
Fringe benefit expenses	1,150	900
General expenses	2,167	2,040
Insurance claims excess	-	(1,270)
Insurance	10,028	8,450
Interest paid	238,544	1,922,496
Loss on sale of assets	1,080	-
Management fees	584,892	468,412
Motor vehicle expenses	21,531	20,662
Motor vehicle bus hire	32,453	40,472
Payroll tax	11,421	9,995
Printing, stationery & postage	30,501	17,285
Provision for employee entitlements	4,118	4,317
Rent	69,844	47,776
Repairs & maintenance	30,024	1,538
Staff training & recruitment	13,091	3,417
Staff amenities	2,281	2,411
Subscriptions and publications	15,628	16,443
Superannuation contributions	8,529	8,302
Telephone	16,748	11,142
Temporary staff	89,084	25,920
Travel expenses	10,096	16,336
Wages and salaries	147,917	126,590
Total expenses	1,583,990	2,871,929
Operating profit	475,075	688,864

The statement of operations has been compiled without audit or review:
refer to compilation report and disclaimer.

CASE 3 - TRUST

	2000 $	1999 $
Accumulated income at beginning	13,647,109	13,647,109
Total available for distribution	14,122,184	14,335,973
Distributions to Beneficiaries	(475,075)	(688,864)
Accumulated income at end	13,647,109	13,647,109

The statement of operations has been compiled without audit or review: refer to compilation report and disclaimer.

CASE 3 - TRUST

BALANCE SHEET AT 30 JUNE 2000
(Unaudited)

	Note	2000 $	1999 $
CURRENT ASSETS			
Cash	2	2,755,264	548,393
Sundry debtors	3	933	20
Loans receivable	4	15,623,959	22,771,391
		18,380,156	23,319,804
NON-CURRENT ASSETS			
Plant and equipment	6	146,659	91,897
Receivables	3	4,150	4,150
Loans receivable	4	1,859,418	1,859,418
Other assets	5	58,739	20,914
		2,068,966	1,976,379
TOTAL ASSETS		20,449,122	25,296,183
CURRENT LIABILITIES			
Trade creditors and accruals	7	156,709	61,035
Loans payable	8	6,615,178	11,562,031
Provisions - other	9	30,086	25,968
		6,801,973	11,649,034
TOTAL LIABILITIES		6,801,973	11,649,034
NET ASSETS		13,647,149	13,647,149
TRUST FUNDS			
Settled sum		20	20
Issued units		20	20
Accumulated income		13,647,109	13,647,109
TOTAL TRUST FUNDS		13,647,149	13,647,149

The balance sheet is to be read in conjunction with the notes to the financial statements and has been compiled without audit or review: refer to compilation report and disclaimer.

CASE 3 - TRUST

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2000

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The significant policies which have been adopted in the preparation of these financial statements are:

Basis of Preparation

In the opinion of the trustee, is not a reporting entity. The financial statements of the trust have been drawn up as a special purpose financial report for use by the trustees and the beneficiaries of the trust and to fulfil the trustees' requirements under the trust deed to prepare financial statements.

The financial statements have been prepared in accordance with all Australian Accounting Standards and other mandatory professional reporting requirements with the following exceptions:

AAS 22 Related Party Disclosures
AAS 28 Statement of Cash Flows
AAS 30 Accounting for Employee Entitlements
AAS 33 Presentation and Disclosure of Financial Instruments

	2000 $	1999 $
2. CASH		
Cash at bank	2,755,264	548,393
3. SUNDRY DEBTORS		
CURRENT		
Sundry debtors	913	-
Cash held in trust	20	20
	933	20
NON-CURRENT		
Security deposits	4,150	4,150
4. LOANS RECEIVABLE		
CURRENT		
Loans, unsecured		
Trust entitlements	4,715,728	4,715,728
Loan	10,908,231	18,055,663
	15,623,959	22,771,391
NON-CURRENT		
Loans, unsecured		
Loan	1,859,418	1,859,418

The notes to the financial statements have been compiled without audit or review: refer to compilation report and disclaimer.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
5. OTHER ASSETS		
NON-CURRENT		
IT project	58,739	20,914
6. PLANT AND EQUIPMENT		
Motor vehicles, at cost	63,853	114,002
Less: Accumulated depreciation	(39,078)	(58,788)
	24,775	55,214
Office fixture, fittings & equipment, at cost	252,763	110,513
Less: Accumulated depreciation	(130,879)	(73,830)
	121,884	36,683
Total plant and equipment, at WDV	146,659	91,897
7. TRADE CREDITORS AND ACCRUALS		
Trade creditors	96,259	27,082
Sundry creditors	60,450	33,953
	156,709	61,035
8. LOANS PAYABLE		
CURRENT		
Loans, unsecured		
Loan	3,983,016	9,404,944
Beneficiary entitlements	2,632,162	2,157,087
	6,615,178	11,562,031
9. OTHER PROVISIONS		
CURRENT		
Provision for employee entitlements	30,086	25,968

CASE 3 - TRUST
TAX RECONCILIATION
CURRENT TAX SYSTEM

Accounting profit/(loss)		**475,075**
Add back timing differences		
Accounting Depreciation	66,991	
Provision for Employee Entitlements - 2000	30,086	
Pre Acquisition Costs - Black Hole Expenditure	2,667	
Non deductible entertainment	2,652	102,396
Less timing differences		
Tax Depreciation	(60,020)	
Provision for Employee Entitlements - 2000	(25,968)	(85,988)
Taxable income/(loss)		**491,483**

CASE STUDY 4 - COMPANY

1. Background

Case Study 4 considers a company in the building industry, which is engaged in long term construction projects.

The construction work in progress is valued at cost less any progress payments received. Income is brought to account on the estimated profits basis. This basis permits the company to spread the ultimate profit or loss on a long term construction project over the years taken to complete the contract provided that the basis is reasonable and is in accordance with the accepted accountancy practices as noted in IT 2450.

As a consequence, the financial statements contain a work in progress account, an equivalent sales account, a construction project cost expense account and an equivalent sales revenue account.

When costs are incurred, the following journal is raised to capitalise the costs incurred.

Work in Progress	Dr	$80	
Bank / Creditors	Cr		$80

When a stage of the building is completed, and say, a $20 profit is realised the following journals are taken up.

Construction Project Costs – Profit and Loss	Dr	$80	
Equivalent Sales – Balance Sheet	Cr		$80

Trade Debtors – Balance Sheet	Dr	$100	
Equivalent Sales – Profit and Loss	Cr		$100

2. Key Findings

Is the correct answer achieved?

With further development of the PDL, in the areas of its application on tax-effect accounting and movements in shareholders equity (including retained profits), the correct answer should be achieved. To achieve the correct outcome in relation to long term construction contracts, it may be relevant to include transactions that arise under such contracts under Division 38 (yet to be drafted).

Subject to the above and comments in earlier case studies regarding difficulties faced with leased assets and non-current assets and liabilities, we believe the correct answer is achievable.

Difficulties/Ease of Application

As noted above, areas of difficulty in this case study were:

- Attributing "Tax Values" to long term construction project transactions;
- Tax-effect accounting entries and their treatment;
- Leases - see Case Study 1; and
- Non-current assets and liabilities and the potential application of Division 45 - see Case Studies 2 and 3.

Availability of Data

Available data comprises the financial statements attached and detailed trial balances for the company's divisions (not attached). This data proved to be adequate for testing.

TAXABLE INCOME OVERVIEW

CASE 4 - COMPANY
METHOD 1 - PROFIT RECONCILIATION METHOD

Operating Profit / (Loss) before Tax	3,886,000
Excess of Movement in Tax Values over Account Values - See Schedule	197,000
Net Income	**4,083,000**
Taxable Income Adjustments - See Schedule	201,000
Unused Tax Losses - See Schedule	-
Total	**4,284,000**

CASE 4 - COMPANY
METHOD 2 - BALANCE SHEET METHOD

Receipts Less Payments (Business) - See Schedule	1,000
Net Change in Tax Values of Assets and Liabilities - See Schedule	4,082,000
Net Income	**4,083,000**
Taxable Income Adjustment - See Schedule	201,000
Unused Tax Losses	-
Total	**4,284,000**

CASE 4 - COMPANY
WORKING SCHEDULE

Taxable Income - 5-15	Notes	Section	Accounts Opening Value	Accounts Closing Value	Accounts Movement	Tax Opening Value	Tax Closing Value	Tax Movement	Profit Rec Method Excess of Tax Over Accounts	Receipts/ Payments (Business)	Receipts/ Payments (Non Business)	Balance Sheet Method Movement in Tax Values	Taxable Income Adj'ment	Unused Tax Losses	Total
Current Assets					-			-							-
Petty Cash		5-55, 5-60	1,000	2,000	1,000	1,000	2,000	1,000		1,000					1,000
Trade Debtors		6-40 Item 6	2,639,000	2,822,000	183,000	2,639,000	2,822,000	183,000				183,000			183,000
Sundry Debtors		6-40 Item 6	475,000	719,000	244,000	475,000	719,000	244,000				244,000			244,000
Provision for Doubtful Debts	4		-	(185,000)	(185,000)	-	-	-	185,000						-
Prepayments		6-40 Item 3	97,000	6,250	(90,750)	97,000	6,250	(90,750)				(90,750)			(90,750)
Advances		6-40 Item 6	-	61,750	61,750	-	61,750	61,750				61,750			61,750
Work in progress - material	1		13,455,000	11,784,000	(1,671,000)	13,455,000	11,784,000	(1,671,000)				(1,671,000)			(1,671,000)
Equivalent sales - building costs expensed	1		(11,292,000)	(8,523,000)	2,769,000	(11,292,000)	(8,523,000)	2,769,000				2,769,000			2,769,000
					-			-							-
Loans Receivable					-			-							-
Loans Receivable - Current		6-40 Item 7	12,949,000	11,700,000	(1,249,000)	12,949,000	11,700,000	(1,249,000)				(1,249,000)			(1,249,000)
					-			-							-
Fixed Assets (Held by Taxpayer)					-			-							-
Plant and equipment (Cost less decline)		40-35	591,000	634,000	43,000	591,000	634,000	43,000				43,000			43,000
Display home furniture (Cost less decline)		40-35	538,000	1,205,000	667,000	538,000	1,205,000	667,000				667,000			667,000
Plant and equipment under lease (Cost less decline)			685,000	346,000	(339,000)	-	-	-	339,000						-
					-			-							
Other Assets					-			-							
Future income tax benefit	3		9,000	149,000	140,000	9,000	149,000	140,000				140,000			140,000
					-			-							-
Current Liabilities					-			-							-
Trade Creditors		7-75(1) Item 5	(6,167,000)	(5,054,000)	1,113,000	(6,167,000)	(5,054,000)	1,113,000				1,113,000			1,113,000
Sundry Creditors		7-75(1) Item 5	(1,811,000)	(1,576,000)	235,000	(1,811,000)	(1,576,000)	235,000				235,000			235,000
Provision for warranties	4		-	(100,000)	(100,000)			-	100,000						-
					-			-							
Leases					-			-							
Lease - Current			(359,000)	(279,000)	80,000	-	-	-	(80,000)						-
Lease - Non Current			(393,000)	(76,000)	317,000	-	-	-	(317,000)						-
					-			-							
Provisions					-			-							
Provision for Income Tax	3		(1,021,000)	(715,000)	306,000	(1,021,000)	(715,000)	306,000				306,000			306,000
Provision for Employee Entitlements	4		(291,000)	(261,000)	30,000	-	-	-	(30,000)						-
					-			-							-
Equity					-			-							-
Share Capital		7-75(1) Item 6	(3,000,000)	(3,000,000)	-	(3,000,000)	(3,000,000)	-							-
Retained Profits	2		-	-	-	-	-	-							
Operating Profit before Tax			-	-		-	-								-
Income Tax Expense	3		-	1,331,000	1,331,000	-	1,331,000	1,331,000				1,331,000			1,331,000
Dividends Paid			-	-		-	-								
Net Income			7,105,000	10,991,000	3,886,000	7,463,000	11,546,000	4,083,000	197,000	1,000	-	4,082,000	-	-	4,083,000
															-
Income Tax Adjustments					-			-							-
Prepayments		*82KZMB ITAA 1936*			-			-					92,000		92,000
Non-Allowable Entertainment Expenses		5-100 Item 9			-			-					36,000		36,000
Non Allowable Donations					-			-					70,000		70,000
Non Allowable Penalties and Fines					-			-					3,000		3,000
Operating Profit before Tax					-			-							-
Tax Losses					-			-							-
Total Taxable Income			7,105,000	10,991,000	3,886,000	7,463,000	11,546,000	4,083,000	197,000	1,000	-	4,082,000	201,000	-	4,284,000

CASE 4 - COMPANY
NOTES AND ASSUMPTIONS

Case studies should be reviewed sequentially. Notes and assumptions common to both this case study and earlier case studies are noted in earlier case studies. Only additional issues relevant to case are noted here.

1. Work in Progress/Equivalent Sales Account

As costs are incurred, they are capitalised to a Work in Progress ("WIP") account. When a stage of the construction project is completed, a proportion of the costs are expensed in the profit and loss statement as a construction project expense. A negative asset is recorded for accounting purposes (the Equivalent Sales Account) to reduce the WIP balance. Income is then brought to account on an estimated profits basis. This treatment is in accordance with IT 2450 for taxation purposes.

Under TVM, some difficulty was encountered. It would appear that the net value of WIP (adjusted for the amount recorded in the "Equivalent Sales – Building Costs expensed" account) is an asset for tax purposes. That is, it embodies future economic benefits. However, it is questionable whether an asset held by the taxpayer (being either property or a right) arises at the time WIP is recognised or only upon completion of a stage. The asset is simply a capitalisation of costs.

IT 2450 indicates that WIP in these circumstances is not trading stock as commonly understood. Under TVM, we would expect any such relevant asset "held" to have no tax value on the basis that this may represent "non-billable work-in-progress". This however would not provide the correct result.

Please refer to our discussion also in Case Study 2 regarding "non-billable work-in-progress".

An alternative approach, is that this WIP is not "non-billable work-in-progress", but falls into the category of "any other asset that you hold" pursuant to s. 6-40, Item 9. In this case, the correct result is achieved as "cost" is taken to be "tax value".

Another alternative would be to treat WIP in the circumstances described as trading stock pursuant to Division 38 (yet to be drafted).

2. Retained Earnings and Capital Accounts

Some difficulty occurred in accounting for the retained earnings account under TVM. The retained earnings account increased with profit for the period, and was reduced by the amount of the accounting Income Tax Expense. As tax effect accounting was adopted, the calculated Income Tax Expense is different to that of the income tax liability. Other possible equity movements could include the payment of dividends, the issue of capital, the reduction of capital etc.

To provide for the correct result, our example simply assumes that retained earnings would not be considered a "liability", nor would the item have a "tax value". Please refer to the following note 3 for a discussion of our treatment of the Income Tax Expense.

3. Income Tax Associated Accounts

In this example, the taxpayer adopts the liability method for accounting for taxation. As such, the balance sheet would disclose the following accounts

- A Future Income Tax Benefit ("FITB") account, used to record the timing difference between accounting and tax, where those timing differences would result in a future reduction in the tax liability of the entity (for example, where a provision for doubtful debts is subsequently written off);

- A Provision for Deferred Income Tax ("PDIT") account, used to record the timing difference between accounting and tax, where those timing differences would result in a future increase in the tax liability of the entity (for example, where accelerated tax depreciation rates are used);

- A Provision for Income Tax ("PIT") account, used to record the net liability owing to the Australian Taxation Office.

- An Income Tax Expense ("ITE") account, used to record the tax effected income tax expense on operating profit.

Consistent with the Income Tax Assessment Act 1936 and 1997, a payment of tax will not entitle the taxpayer to a deduction (s. 25-5(2)(a)). We expect a similar rule would result under TVM. This effectively would nullify the movement in the PIT liability. To achieve the correct outcome it might be relevant to give the PIT a "Tax Value" equal to its "Book Value".

Although the ITE figure is a tax effect figure only and, (by reason of taxation timing differences), may not represent the company's present tax owing, it is necessary to take into account the closing balance of that item to correctly determine the Net Income figure. Our Working Schedule effectively treats the ITE as an "asset", with only a closing tax value.

However, the treatment of the FITB, PDIT, and ITE account was uncertain under TVM. The FITB account would appear not to result in an asset "held" by the taxpayer, as the taxpayer does not hold a right or property. Furthermore, in our view the PDIT would not result in a liability that the taxpayer "has", as there is not a present obligation of the taxpayer at that time.

There appears to be two methods of achieving the correct outcome.

The first method is to:

- Allocate a "Tax Value" to opening and closing PDIT/FITB balances;
- Allocate a "Tax Value" to both opening and closing PIT balances; and
- Recognise only a closing ITE "Tax Value".

Our Working Schedule reflects the method noted above.

The second method is to:

- Not recognise any "Tax Values" for PDIT/FITB, PIT or ITE balances; and
- Treat income tax paid/(refunded) as a Taxable Income Adjustment.

Overall, some difficulty was experienced in determining the movement in retained earnings, and the proper accounting for income tax related accounts under TVM.

4. Provisions

The company's provisions have been accounted for on the basis that a present obligation has not arisen at year end. Thus, the company does not "have" a liability for PDL purposes. The outcome is consistent with the application of existing legislation in the client's case.

CASE 4 - COMPANY

MANAGEMENT REPORT
(Unaudited)

FOR THE YEAR ENDED

30 JUNE 2000

CASE 4 - COMPANY

STATEMENT OF OPERATIONS FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
INCOME		
Trading income	81,996,000	92,179,000
Sundry income	141,000	180,000
Total income	82,137,000	92,359,000
EXPENSES		
Operating expenses	78,251,000	87,023,000
Total expenses	78,251,000	87,023,000
Operating profit before tax	3,886,000	5,336,000
Income tax expense	(1,331,000)	(1,956,000)
Operating profit after tax	2,555,000	3,380,000
Retained profits at beginning	7,105,000	3,725,000
Retained profits at end	9,660,000	7,105,000

The statement of operations has been compiled without audit or review:
refer to compilation report and disclaimer.

CASE 4 - COMPANY

BALANCE SHEET AT 30 JUNE 2000
(Unaudited)

	Note	2000 $	1999 $
CURRENT ASSETS			
Cash	2	2,000	1,000
Trade debtors	3	2,822,000	2,639,000
Sundry debtors	4	534,000	475,000
Loans receivable	5	11,700,000	12,949,000
Prepayments and other assets	6	68,000	97,000
Stock on hand	7	3,261,000	2,163,000
		18,387,000	18,324,000
NON-CURRENT ASSETS			
Plant and equipment	8	2,185,000	1,814,000
Other assets	6	149,000	9,000
		2,334,000	1,823,000
TOTAL ASSETS		20,721,000	20,147,000
CURRENT LIABILITIES			
Trade creditors and accruals	9	6,630,000	7,978,000
Lease liabilities	10	279,000	359,000
Provision for income tax		715,000	1,021,000
Provisions - other	11	361,000	291,000
		7,985,000	9,649,000
NON-CURRENT LIABILITIES			
Lease liabilities	10	76,000	393,000
		76,000	393,000
TOTAL LIABILITIES		8,061,000	10,042,000
NET ASSETS		12,660,000	10,105,000
SHAREHOLDERS' EQUITY			
Share capital		3,000,000	3,000,000
Retained profits		9,660,000	7,105,000
TOTAL SHAREHOLDERS' EQUITY		12,660,000	10,105,000

The balance sheet is to be read in conjunction with the notes to the financial statements and has been compiled without audit or review: refer to compilation report and disclaimer.

CASE 4 - COMPANY

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2000

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The significant policies which have been adopted in the preparation of these financial statements are:

Basis of Preparation

In the opinion of the directors, the company is not a reporting entity. This special purpose financial report of the company has been drawn up for distribution to the members of the company for the purpose of meeting their information needs.

The financial statements have been prepared in accordance with all Australian Accounting Standards and other mandatory professional reporting requirements with the following exceptions:

AAS 3	Accounting for Income Tax
AAS 22	Related Party Disclosures
AAS 28	Statement of Cash Flows
AAS 30	Accounting for Employee Entitlements
AAS 33	Presentation and Disclosure of Financial Instruments

	2000 $	1999 $
2. CASH		
Petty cash	2,000	1,000
3. TRADE DEBTORS		
Trade debtors	2,822,000	2,639,000
4. SUNDRY DEBTORS		
CURRENT		
Sundry debtors	719,000	475,000
Less: Provision for doubtful debts	(185,000)	-
	534,000	475,000
5. LOANS RECEIVABLE		
CURRENT		
Loans, unsecured		
Loan, other	103,000	-
Loan, other	11,597,000	12,949,000
	11,700,000	12,949,000

The notes to the financial statements have been compiled without audit or review: refer to compilation report and disclaimer.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
6. OTHER ASSETS		
CURRENT		
Prepayments and advances	68,000	97,000
NON-CURRENT		
Future income tax benefit	149,000	9,000
7. STOCK ON HAND		
CURRENT		
Work in progress - material	11,784,000	13,455,000
Equivalent sales - build cost	(8,523,000)	(11,292,000)
	3,261,000	2,163,000
8. PLANT AND EQUIPMENT		
Plant and equipment, at cost	1,174,000	960,000
Less: Accumulated depreciation	(540,000)	(369,000)
	634,000	591,000
Display home furniture, at cost	3,466,000	2,133,000
Less: Accumulated depreciation	(2,261,000)	(1,595,000)
	1,205,000	538,000
Plant and equipment under lease	672,000	1,051,000
Less: Accumulated amortisation	(326,000)	(366,000)
	346,000	685,000
Total plant and equipment, at WDV	2,185,000	1,814,000
9. TRADE CREDITORS AND ACCRUALS		
Trade creditors	5,054,000	6,167,000
Sundry creditors	1,576,000	1,811,000
	6,630,000	7,978,000

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2000

	2000 $	1999 $
10. LEASE LIABILITIES		
Finance lease rentals are payable as follows:		
Lease liability	279,000	359,000
Lease liability	76,000	393,000
Gross lease rentals	355,000	752,000
Net lease rentals	355,000	752,000
Amounts recognised in the accounts:		
Current	279,000	359,000
Non-current	76,000	393,000
Total lease liability	355,000	752,000
11. OTHER PROVISIONS		
CURRENT		
Provision for employee entitlements	261,000	291,000
Provision for warranties	100,000	-
	361,000	291,000

The notes to the financial statements have been compiled without audit or review: refer to compilation report and disclaimer.

CASE 4 - COMPANY
TAX RECONCILIATION
CURRENT TAX SYSTEM

Accounting profit/(loss)			**3,886,000**
Add back timing differences			
Provision for Employee Entitlements - 2000	261,000		
Provision for Warranties - 2000	100,000		
Provision for Doubtful Debts - 2000	185,000		
Leased assets - amortisation	176,000		
Leased assets - interest	48,000		
Depreciation as per accounts	839,000		
Entertainment expenses	36,000		
Prepayments - 1999	97,000		
Penalties and fines	3,000		
Royal Children's Hospital donation	70,000		1,815,000
Less timing differences			
Provision for Employee Entitlements - 1999	(291,000)		
Tax Depreciation	(839,000)		
Actual lease payments	(282,000)		
Prepayments - 2000 (80% of $6,250)	(5,000)		(1,417,000)
Taxable income/(loss)			**4,284,000**

CASE STUDY 5 – KEY MAN INSURANCE

1. Background

A company (with a turnover greater than $1 million) has paid a "key man" insurance policy premium on 30 June 2000, in relation to an employee. The payment is for 12 months insurance cover for the following financial year.

The term "key man" is used to denote insurance on the life of a person who has important status in the employer's business such as a director. The types of policies involved are typically whole of life, endowment, term life assurance, sickness and accident insurance.

The case study considers the treatment of "key man" accident or term insurance policies. It is the Commissioner's practice to generally treat the premiums as deductible and the proceeds as assessable income when the proceeds "fill the place of a revenue receipt" as per IT 155.

2. Payment of Premium

Current Law

It appears that the Commissioner's practice as per IT 155 in the circumstances described is consistent with the correct application of the current law. In the case of "key man" accident or term insurance policies, premiums will be deductible (section 8-1) and proceeds will be assessable (section 6-5) where the purpose of the insurance was "to fill the place of a revenue receipt which the event insured against has prevented from arising or of any outgoing which has been incurred on revenue account in consequence of the event insured against ...".

For prepayments made in the course of business (for taxpayers whose turnover ex-GST exceeds $1 million) during the 2000 year or later years, the timing of deductions are deferred in accordance with section 82KZME. After 2002/2003, advance deductions for prepaid expenditure will not be available for larger business taxpayers.

Accounting Treatment

The accounting treatment in relation to the payment of the premium by the company is to expense the amount paid by the company.

Prototype Draft Legislation ("PDL")

An asset is defined as 'anything that embodies future economic benefits' pursuant to section 6-15 of the PDL.

Subsection 6-18(3) considers contingent rights under an arrangement. It states that the rights that you start to have under an arrangement because some contingency is met are not part of the same asset as the rights that you have under the arrangement regardless of whether that contingency is met.

Payment of the insurance premium entitles the company to rights, regardless of whether or not a relevant contingent event occurs under which the company would make a claim under the policy.

These rights that the company has under this arrangement can be regarded as an asset pursuant to section 6-15. It would appear that under section 6-20 Item 1 or 2 that the asset is "held" by the company. Therefore, the tax value of the asset can be determined with reference to section 6-40 Item 3 which considers the tax value of depreciating assets (a depreciating asset is defined in section 40-30). Under section 40-35 the tax value of the depreciating assets is the asset's base value less its decline in tax value. Refer also to section 40-40 which notes that the "straight line method" is relevant for determining the decline in "Tax Value" of rights to insurance.

By treating the insurance premium prepayment as a depreciating asset, the proposed tax value method treatment would be consistent with the eventual outcome of the current law, being to align the deduction with the period over which the service is provided.

3. Event happening

Current Law

Generally, once-off receipts such as life insurance payments, are derived only upon being received. The occurrence of a contingent event which gives rise to a claim does not usually trigger an assessable amount at that point of time. If it did, taxpayers might be assessable on amounts they may never receive, in the event they did not pursue claims.

Prototype Draft Legislation

A new asset comes into existence under section 6-18 once the event occurs.

This is illustrated in Example 2 to subsection 6-18(3) which states that the right of an insured entity, under an insurance contract, to the provision of insurance against the risk concerned are not part of the same asset as the insured's right to have the claim satisfied once an event has happened in respect of which the insured entity can claim under the contract.

Subsection 6-18(4) then goes on to state that the insured's right to have the right claim satisfied is treated as not arising under the insurance contract. The insured is treated as getting that right for nothing when the event insured against happens.

The effects of getting the rights for nothing are examined in section 8-55. Section 8-55 outlines that an entity is taken to receive, from the other entity, an amount equal to the market value of the benefit, and to have paid the same amount for the benefit, at the time when it gets it.

This rule treats the non-cash transaction as if the provider of the non-cash benefit had financed the purchase of that benefit by providing the other party with sufficient money to enable it to effect a purchase at market value.

Therefore, it is when the event happens that the new asset is created.

The entity is taken to "hold" this new asset under either section 6-20 Item 1 or Item 2. It appears that the tax value of the asset can be determined with reference to section 6-40 Item 5 or 6 which consider the "tax value" of financial assets. The tax value of such assets is stated as the amount that the company has the right to receive.

The impact of the PDL therefore appears to be to accelerate the recognition of assessable income arising from insurance claims.

4. Satisfaction of Claim

Current Law

Upon receipt of the money paid in satisfaction of the claim, the amount received is usually taken to have been derived as assessable income at that point in time.

Prototype Draft Legislation

When an amount is paid in satisfaction of an insurance claim, it appears that a taxable event does not arise. That is;

- there is a "Receipt" equal to the amount paid, and
- the new asset that came into existence by reason of the insurable event is disposed of resulting in an equal reduction in "Taxable Value" of the asset to the "Receipt".

5. Summary

In summary, the PDL appears to provide a consistent outcome in relation to deductions for premiums but appears to accelerate the recognition of assessable proceeds received under an insurance claim.

The outcomes noted above are not restricted to keyman insurance premiums and claims but would be relevant to all forms of business or income protection insurance.

This case study has only considered a circumstance where the insurance premium is deductible and the proceeds received in the event of a claim are assessable. In cases where the premiums are non-deductible and the proceeds are not assessable (or are subject to specific CGT treatment) we anticipate that Income Tax Adjustments will be necessary.

CASE STUDY 6 - ACQUIRED INCOME STREAM

1. Background

A client is currently purchasing a right to an income stream. For the purposes of example, it might be assumed that $60,000 is to be paid for the rights to receive $100,000 rental (10 annual instalments of $10,000 each) over the next ten years.

2. Key Findings

Current Law

Prima facie the acquisition of rights to benefits to be provided over a ten-year period would appear to be on capital account.

Thus, no immediate deduction or capital allowance write-off appears to be available under existing provisions. Subject to the terms of the arrangement, our client may however potentially be the holder of a qualifying security for the purposes of Division 16E of the 1936 Income Tax Assessment Act.

Division 16E broadly provides that the difference between the purchase price paid of $60,000 and the $100,000 to be received over ten years would be assessable to our client on an accruals basis.

Should Division 16E not be relevant, then our client might at best expect a capital loss of $60,000 after ten years when her rights expire under this arrangement.

Tax Value Methodology

Pursuant to s. 6-15, s. 6-20 and s. 6-40 respectively our client would appear to:

- Have acquired an "Asset";
- "Hold" that asset; and
- The asset would initially have a "Tax Value" of $60,000;

Division 45 and 45-C would appear to impact the "Tax Value" of that asset over the ten-year period so that over the period the "Tax Value" would:

- Increase by an "interest %" factor; and
- Decrease by the annual $10,000 payments.

The net result appears to be that the intention of Division 45 is to bring the $40,000 difference between the issue price of the income stream of $60,000 and its face value of $100,000, to account as assessable income on an accruals basis over the ten year period. This assumes that Division 45 is reviewed to ensure it operates as intended. Please refer to our comments to Case Study 2.

This outcome appears to mirror the Division 16E outcome under existing law. However, should Division 16E not apply to these circumstances, TVM appears to give to a substantially different outcome.