THE CHARTERED INSTITUTE OF TAXATION

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

May 2005

PAPER II

ADVANCED INTERNATIONAL TAXATION

A – UNITED KINGDOM

TIME ALLOWED – 3 HOURS

Candidates should answer any **two** questions from Part I and any **two** questions from Part II. Each question will carry equal marks.

Start each answer on a fresh sheet.
All workings should be made to the nearest month and pound unless the question requires otherwise.
Marks are specifically allocated for good presentation.
Unless the question specifically requires you to discuss EC aspects, you should assume that all the countries mentioned are not members of the EC and that you do not need to discuss EC aspects in your answer.

PART I

You are required to answer **TWO** questions from this Part.

1. 1) You have been consulted by Mr Pierus, the finance director of Clio Technologies Ltd, a United Kingdom incorporated manufacturer of IT equipment. He has explained to you that, up to now, the company's trading activities have been confined to the United Kingdom but the directors consider that continuing growth will require the company to expand significantly overseas. The directors have also established that there are significant opportunities to lower the cost of manufacture by undertaking manufacturing in overseas locations.

Accordingly, Mr Pierus has informed you that entities will require to be formed in several jurisdictions. There will be some significant start-up costs but it is hoped that most locations will become profitable in quite a short period. As well as manufacturing in overseas locations, it is intended to set up a distribution centre in each of the western and eastern hemispheres to distribute product to customers on an international basis.

The company's in-house legal team has carried out some initial research and has determined that some jurisdictions will require the incorporation of a local subsidiary while others will allow trading through a local branch.

Mr Pierus has asked for your advice on the taxation implications of the proposed expansion.

You are required to outline the advice which you would give to Mr Pierus on UK corporate tax issues relevant to these proposals. (14)

2) Mr Pierus has gone on to explain that a number of employees will be required to go out from the United Kingdom to help to set up and run these overseas operations. It is anticipated that these will be temporary assignments and that the employees will return to the UK within a two year period.

You are required to explain the taxation implications for the employees and the company's obligations in relation to PAYE and national insurance. (6)

3) As part of the ongoing arrangements with the foreign entities, Clio Technologies Ltd will be supplying goods and services to them, including management services and the services of various in-house departments. Mr Pierus has asked you to explain whether VAT will require to be charged on these supplies.

You are required to outline the advice which you would give to Mr Pierus. (5)

Total (25)

2. 1) You are the tax adviser to the Euterpe Group, a multinational group of companies in the entertainment industry, headquartered in the United Kingdom. The group has a policy of regularly moving senior executives to overseas locations for a few years at a time. The group is considering the introduction of a share option scheme, the terms of which would not be such as to obtain Inland Revenue approval under Chapter 8 Part 7 ITEPA 2003. You have been asked to comment on the liability to United Kingdom tax in respect of gains arising under the share option scheme for internationally mobile employees including, in particular, those who will temporarily relocate to the United States as well as to certain Latin American countries with which the United Kingdom does not have a double taxation convention.

You are required to outline the advice which you would give to the Euterpe Group. (8)

2) The Euterpe Group has decided that certain employees are to be made redundant including some who have served overseas. They are to receive ex-gratia payments from the Group in connection with the loss of employment.

You are required to explain the United Kingdom taxation liability which will arise on these payments. (6)

3) **You are required to explain the importance of the concept of domicile in determining liability to Inheritance Tax in the United Kingdom.** (11)

Total (25)

3. 1) The concept of residence is fundamental to United Kingdom taxation.

You are required to explain, with reference to statute, case law and Inland Revenue practice the circumstances under which a company will be regarded as resident in the United Kingdom for tax purposes. (13)

2) It is possible for a company to be resident for tax purposes in more than one country.

You are required to explain how the OECD Model Double Taxation Convention determines residence for tax treaty purposes in these circumstances and the guidance available to United Kingdom companies to assist in that determination. (4)

3) A company may cease to be resident for taxation purposes in the United Kingdom.

You are required to explain the United Kingdom taxation consequences of company migration from the United Kingdom. (8)

Total (25)

PART II

You are required to answer **TWO** questions from this Part.

4. A plc is the UK resident parent of B Ltd, a UK resident sub-holding company which owns two Arowanese resident subsidiaries, C SL and E SL. A plc recently acquired X SA, a Bergaman resident company which has a Arowanese resident subsidiary, D SL. Following the acquisition A plc wishes to consolidate the Arowanese operations of the two sub-groups and has devised the following proposal that is intended to create Arowanese tax deductions for interest paid by C SL to X SA with no Bergaman tax on the interest income due to Bergaman tax trading losses brought forward of X SA.

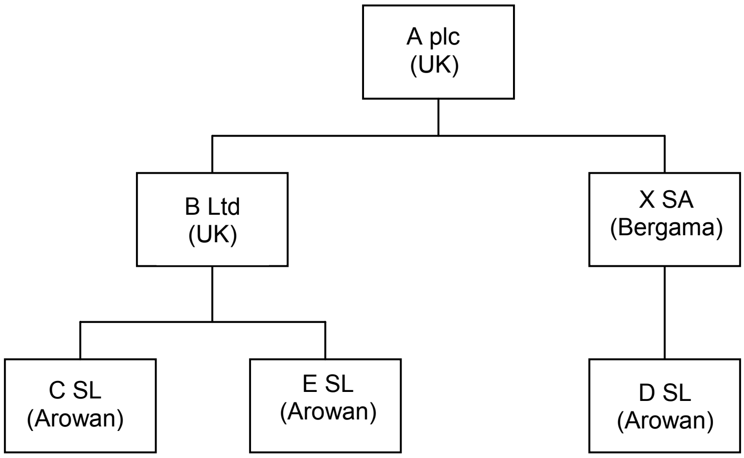
    1) B Ltd contributes cash of €200m to X SA in exchange for an issue of shares.

    2) X SA lends €200m to C SL.

    3) C SL uses the cash to acquire D SL from X SA.

    4) B Ltd contributes E SL to C SL in exchange for an issue of shares.

    An abbreviated group structure before the proposals set out above is:



    All shareholding relationships are 100%.

    You are required to advise on the UK tax implications of the above proposal including the controlled foreign company ("CFC") status of X SA and the capital gains, stamp duty and Treasury consent implications. Please ignore the double tax relief implications of the resulting structure. (25)

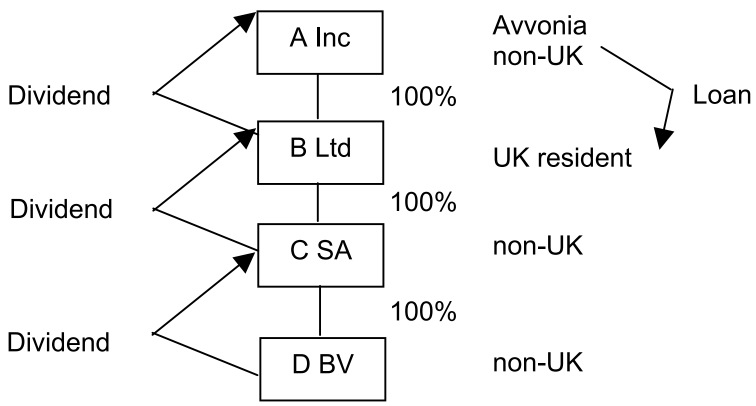
5. A Inc. is resident in Avvonia, and owns 100% of B Ltd, which owns 100% of C SA which owns 100% of D BV. A Inc., C SA and D BV are companies resident outside the UK and B Ltd is a UK resident company.

A Inc. has made a loan to B Ltd.

Dividends have been paid by D BV, C SA and B Ltd during the year ended 31 December 2004.

Double Tax Treaties in accordance with the OECD Model Convention on Income and Capital are in place between the UK, Avvonia and countries of residence of C SA and D BV.

The following diagram is produced to assist you.



You are required to:

1) **Describe how Avvonia and the UK may tax the interest and dividend payments made by B Ltd and the dividend payment by C SA by reference to the double tax treaty in force between the countries concerned, including the conditions that will need to be satisfied to obtain any relief available under the double tax treaty.**

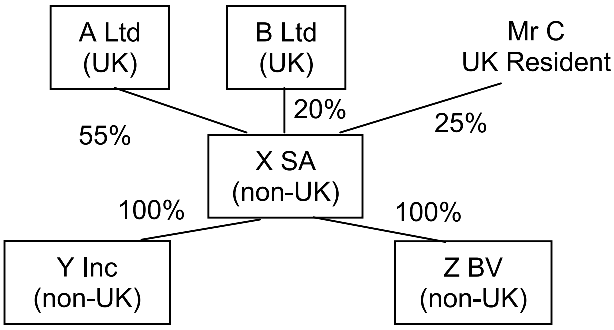
   Consider the UK domestic tax treatment for B Ltd, including the application of the UK transfer pricing rules, as well as its position under the double tax treaties (but not the domestic tax treatment of the other countries). (21)

2) **Describe the general procedure that needs to be followed by A Inc. to claim relief under the double tax treaty between the UK and Avvonia.** (4)

Total (25)

6. X SA is a non-UK resident company that is owned by the following shareholders:

- A Ltd, a UK resident company, owns 55% of X SA;
- B Ltd, a UK resident company, owns 20% of X SA;
- Mr C, a UK resident individual, owns 25% of X SA.



In the year ended 31 December 2004, the following transactions were relevant to X SA:

- A loan of $1bn to its 100% subsidiary Y Inc. on which interest is charged at 4%. As well as earning interest income of $40m (€30m) on this loan a foreign exchange gain of $60m (€40m) accrued on this loan during the period. This loan was originally made in July 2001 and the principal amount has not changed since that time.
- A loan to another 100% subsidiary Z BV of €250m on which no interest was charged during the year. This loan was originally made in November 2002 and the principal amount has not changed since that time.
- A loan to A Ltd of €200m on which no interest was charged. This loan was originally made in July 2002 and was repaid by A Ltd to X SA on 31 March 2004. A Ltd has recognised a foreign exchange loss of €10m (£6m) on this loan during the year.
- X SA disposed of an investment for total sale proceeds of €200m, and recognised a profit on sale of €20m, which was also the chargeable gain that would have arisen under UK capital gains principles.
- X SA paid tax of €5m on its profits for the year and also suffered withholding tax of $4m (€3m) on the interest income from Y Inc.
- X SA paid a dividend of €60m to its shareholders out of the profits of the year.

You should assume that:

- X SA has always prepared its accounts in €;
- the interest charged on the loan to Y Inc. is an arm's length interest rate under UK transfer pricing principles;
- an arm's length interest rate on the two € loans to Z BV and A Ltd would be 4%;
- X SA, Y Inc. and Z BV are all resident in different countries.

You are required to:

Describe the controlled foreign companies ("CFC") status of X SA for the year ended 31 December 2004 including any exemptions (other than the CFC motive test or public quotation exemptions) that may apply to a CFC apportionment for the company.

Calculate the liability (if any) under the UK CFC rules which any of the shareholders of X SA may have in respect of the year ended 31 December 2004. You are not required to calculate the UK tax liability in respect of the X SA dividend. (25)

7. 1) X Ltd, a UK resident company, licenses as part of its trade intellectual property to UK and non-UK residents. Some of the non-UK royalties received suffer deduction of tax at source at various rates.

In the year ended 31 December 2004 the Schedule D Case I profits of X Ltd were:

	£m
UK royalties	20
Non-UK royalties	10
Amortisation of intangibles	(5)
General expenses	(13)
Case I profit	12

Withholding tax of £2m was suffered on the foreign royalties.

You are required to describe three different methods by which double tax relief could be computed in the UK for the foreign withholding tax, providing support from UK domestic law to justify how much relief should be given under each method. Please also compute the quantum of relief available under each method. (15)

2) Y Ltd, a UK resident company, has made a loan to its 100% owned non-UK resident subsidiary Z SA. The loan is denominated in € although the functional currency of Y Ltd is £. In the years ended 31 December 2002, 2003 and 2004 Y Ltd accrued interest income on the loan of €10m (£6m), €15m (£9m) and €20m (£15m) respectively. Y Ltd also recognised foreign exchange movements on the loan in these years of a gain of £2m in 2002, a loss of £5m in 2003 and a gain of £3m in 2004.

The accrued interest recognised in the three years was paid in one lump sum in November 2004 and withholding tax of €4.5m (£3m) was deducted from the gross interest of €45m, such that Y Ltd received cash of €40.5m (£27m).

Y Ltd also accrued the following UK interest income and expense in the years ended 31 December 2002, 2003 and 2004:

	2002	2003	2004
	£m	£m	£m
Interest income	5	8	3
Interest expense	(10)	(20)	(8)

Y Ltd also received a dividend from Z SA of €12m (£8m) in 2003 which had suffered withholding tax of €3m (£2m). No underlying tax was available for relief.

In the year ended 31 December 2003, A Ltd, a 100% UK resident subsidiary of Y Ltd had UK taxable profits of £10m.

You are required to compute the UK tax payable by Y Ltd for the years ended 31 December 2002, 2003 and 2004, and by A Ltd for the year ended 31 December 2003, after relief for the foreign withholding tax and assuming that maximum reliefs are claimed such that the minimum amount of tax is paid by Y Ltd. (10)

Total (25)