THE CHARTERED INSTITUTE OF TAXATION

# THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

May 2004

# PAPER II

## ADVANCED INTERNATIONAL TAXATION

A - UNITED KINGDOM

TIME ALLOWED - 3 HOURS

Candidates should answer any **four** out of seven questions.
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.

1.

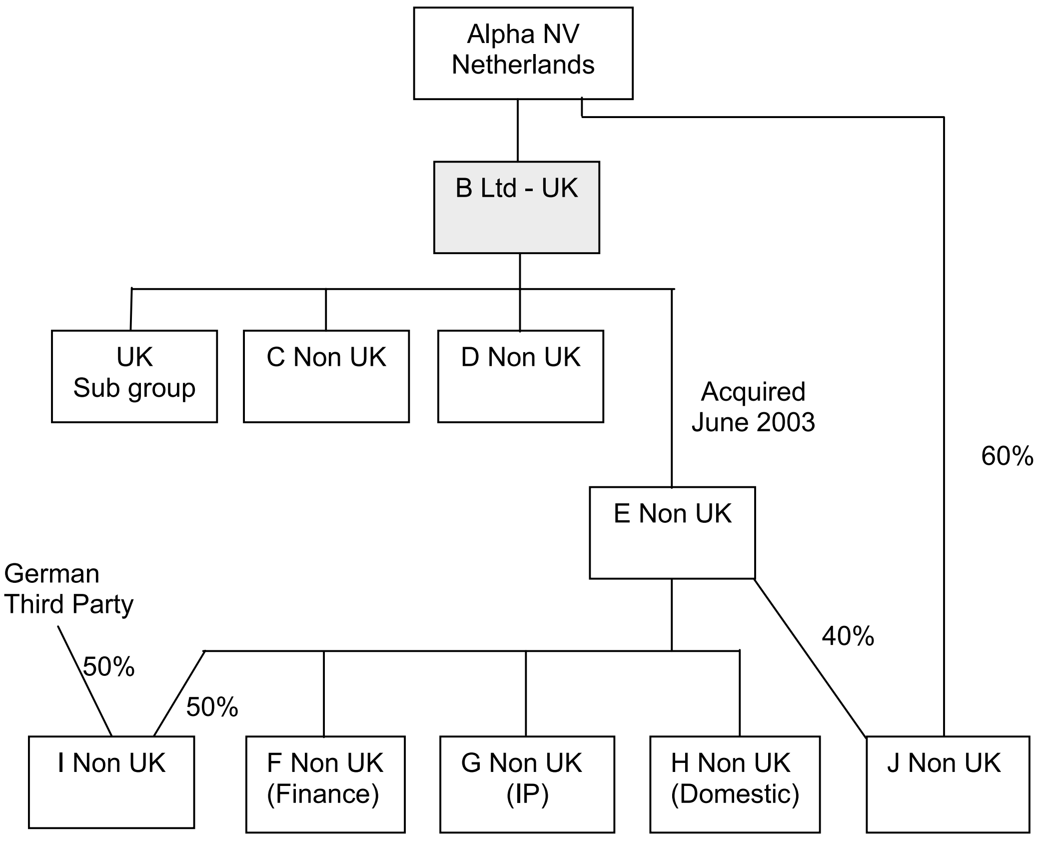
1) Alpha NV is the parent company of a multinational group which has operations in a number of countries. Alpha NV is resident in the Netherlands. It has a directly owned UK subsidiary, B Ltd, which has a number of UK subsidiaries and also two subsidiaries, C and D, which are resident in third countries.

C buys goods from Alpha NV and sells them in the same form to D, which sells the goods to the public. C is taxed at 10% and D at 40%.

In June 2003, B Ltd acquired company E, which is the parent company of companies, F, G and H, and which also has a 50% interest in company I and a 40% interest in company J. The remaining 50% of company I is owned by a third party that is resident in Germany, and the remaining 60% of J is already owned by Alpha NV. These percentage interests also represent the percentage of votes each shareholder has in I and J. The constitutions of both I and J require at least 51% of votes to make decisions. E was formerly owned by a number of non-UK resident individuals. E, F, G, H, I and J are all non-UK resident companies.

Company F is a finance company and lends funds to companies G and H. Its activity has remained unchanged since acquisition. Company G's business is holding and licensing intellectual property. Since E's acquisition by B Ltd, the intellectual property of company G has been licensed to companies C and D, prior to that date it licensed to company H only. E's income consists of dividends from F and H, and interest income from H. H manufactures and sells its products in its country of residence only. All companies prepare accounts to 31 December annually.

A diagram of the group after the acquisition of the E group is shown below.




**You are required to comment on the application of the UK CFC legislation to these circumstances for the year ending 31 December 2004. Also comment if the UK CFC implications for the year ending 31 December 2005 will be any different.** (15)



*Continued*

1. *Continuation*

2) A plc is the UK parent of a group of companies which manufacture and sell cars. A plc has a subsidiary, B, based in Guernsey whose sole activity is providing insurance (not long-term insurance, or insuring or reinsuring large risks) for customers who purchase cars from A. Contracts for the insurance are between B and the customers, 70% of whom are UK resident individuals, and pay their insurance premiums directly to B in Guernsey. B pays very little tax on its profits. B made profits in the years ended 31 December 2002 and 2003.

**Comment on the UK CFC position of B for the years ended 31 December 2002 and 2003.** (5)

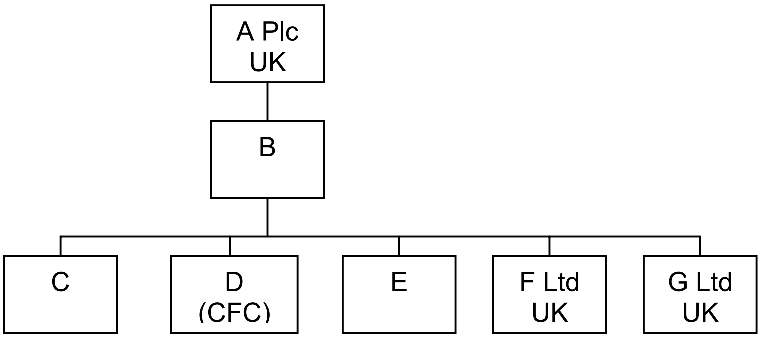
3) Yellow BV is a Dutch resident company owned by X plc, a UK resident parent company. Yellow BV has for many years licensed intellectual property to Zen BV, another Dutch resident company owned by X plc, which sub-licenses the intellectual property to X plc. Yellow BV and Zen BV have been owned by X plc for a number of years. Very little tax is paid by Yellow BV in the Netherlands due to amortisation of the intellectual property for Dutch tax purposes.

**Comment on the UK CFC status of Yellow BV and Zen BV.** (5)

Total (25)

2.

1)




A plc is the UK resident 100% parent company of a number of subsidiaries owned as shown in the above legal structure. Companies B, C, D and E are all resident outside the UK, but in different countries, and companies F Ltd and G Ltd are resident in the UK.

A plc is planning a share buy-back and wishes to repatriate all of the retained earnings of its subsidiaries to the UK as dividends in the current financial year (other than current year earnings). Other than company C, all pre 2003 earnings have been paid to the UK already.

Related information is as follows:

| | Company C | | | Company D | Company E | Company F Ltd | Company G Ltd |
|---|---|---|---|---|---|---|---|
| | Pre 2002 | 2002 | 2003 | 2003 | 2003 | 2003 | 2003 |
| Pre-tax profits | Nil | 300 | 500 | 200 | 300 | 400 | 300 |
| Tax per accounts | Nil | (100) | (200) | (10) | (50) | (120) | (100) |
| Distributable profits | Nil | 200 | 300 | 190 | 250 | 280 | 200 |
| Tax paid for the year | Nil | 200 | 180 | 15 | 60 | Nil | 150 |

All of the above amounts are in £'000.

Further information you have been told is:

- Companies C and E are not CFC's
- Company D is a CFC and must either suffer a CFC apportionment for 2003 or pay a dividend to satisfy the CFC acceptable distribution policy for that year.
- Company F did not pay any UK tax in 2003 as it claimed group relief from A plc.
- All dividends must be paid in 2004.
- None of the dividends will give rise to a withholding or other non-UK tax cost under the current structure.
- All companies have a December 2004 year end.
- B is purely a holding company with no income other than the dividends from its subsidiaries. B has no tax on dividends received or on capital gains.

2. *Continuation*

**You are required to:**

**(a) Prepare the UK tax computation for A plc assuming full distribution of the above profits, including a computation of any eligible unrelieved foreign tax ("EUFT") arising.** (12)

**(b) Advise on how to reduce the UK tax payable on repatriation of the above profits. Assume that it is not possible to change the year end of company B. Your advice should consider a number of possible alternatives, but consider the relevant UK tax issues for only one of those alternatives, and should contain computations where relevant. Any foreign tax issues that could arise for that option should also be identified but only discussed in general terms.** (9)

2) A UK company operates through branches in two separate countries.

**Explain how double tax relief is granted in the UK for foreign tax paid in each branch, including the treatment of any taxes paid above the UK rate.** (4)

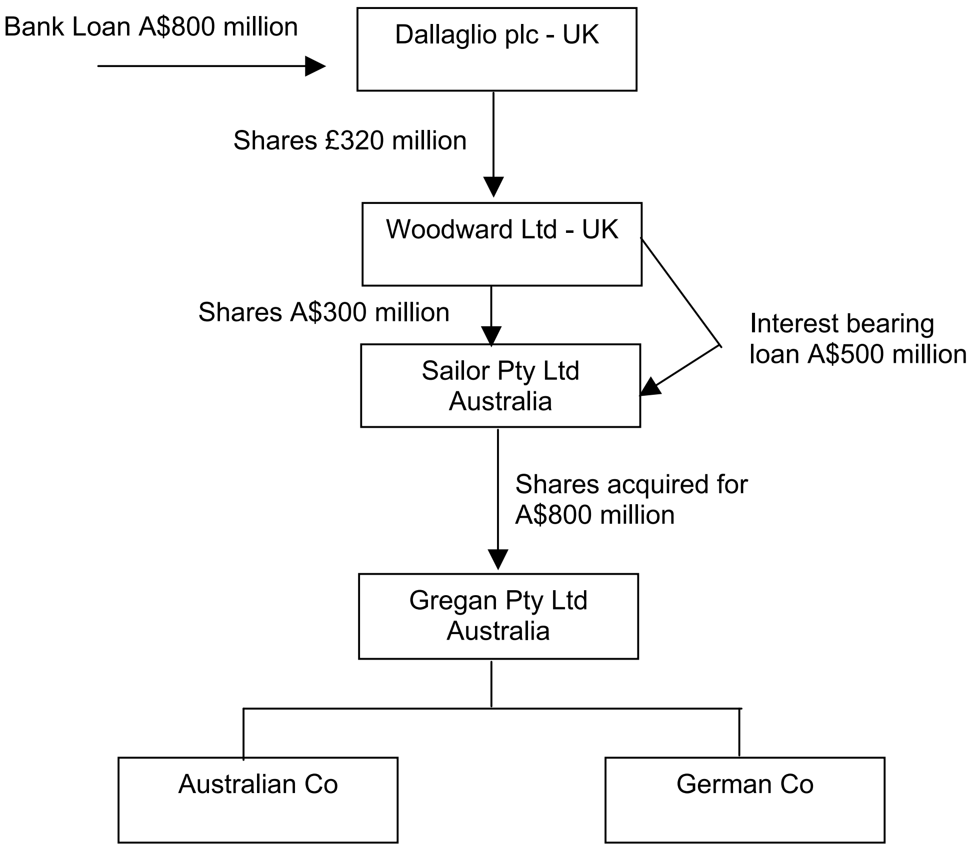
Total (25)

3\.

1) During 2003 the Dallaglio plc group acquired the Gregan Pty Ltd group for A$800 million. Dallaglio plc is a UK resident company and Gregan Pty Ltd is an Australian resident company. The acquisition was funded entirely through a bank loan of A$800 million to Dallaglio plc, which used the cash to subscribe for 320 million £1 ordinary shares in a 100% owned UK subsidiary, Woodward Ltd (£1 = A$2.5 at the date of subscription). Woodward Ltd used A$300 million of the cash to subscribe for new shares of a 100% owned Australian subsidiary, Sailor Pty Ltd. Woodward Ltd loaned the remaining A$500 million to Sailor Pty Ltd on an interest bearing basis. Sailor Pty Ltd acquired the shares of Gregan Pty Ltd for A$800 million. Sailor Pty Ltd has elected to file a consolidated tax return in Australia for itself and the other Australian companies.

   The Dallaglio plc group has existing operations in the UK and France, the latter business being carried on through a branch of Dallaglio plc in France. The Gregan Pty Ltd group has operations in Australia and Germany, carried on through subsidiaries in these countries.

   The following diagram is produced to assist you.




*Continued*

3. *Continuation*

(a) **The tax manager of Dallaglio plc retired recently and the finance director has asked you to advise on all relevant UK tax issues associated with the above structure, as he is unable to find any information on his internal files. Your advice should include the issues arising in setting up the structure, and also the ongoing UK tax implications of the structure, including any advice to improve the UK tax position. However, you do not need to consider the administrative issues associated with filing Corporation Tax or VAT returns.** (7)

(b) The group wishes to expand its French operations, and the finance director has been advised that commercially this will require a French subsidiary to be formed.

**Advise on the UK tax implications of transferring the business of the French branch to a new French subsidiary of Dallaglio plc, including detail of any relief available to avoid or reduce any UK tax that may arise.** (8)

(c) The group wishes to transfer ownership of the German company from Gregan Pty Ltd to Woodward Ltd, and has been advised that this will not give rise to an Australian tax charge.

**Advise on the UK tax implications of transferring the German company.** (3)

2) **Explain how to determine the characterisation of a non-UK entity for UK Corporation Tax purposes (i.e. whether or not it is fiscally transparent), and how this characterisation impacts on UK resident corporate owners of such an entity. Refer to relevant case law where appropriate.** (7)

Total (25)

4.

1) The concepts of residence and ordinary residence are important in determining the liability of an individual or trustees to Income Tax and Capital Gains Tax in the United Kingdom.

   **You are required to explain these concepts as they affect individuals and trustees by reference to statute, case law and Inland Revenue practice.** (11)

2) An individual who is not resident in the United Kingdom may be liable to Capital Gains Tax in the United Kingdom in respect of events occurring during his non-residence.

   **You are required to explain the circumstances under which such a liability may arise.** (7)

3) Crooktown Management Ltd is a UK resident entertainment management company whose clients include Dagon, a Canadian band with four members, which is to play two concerts in the United Kingdom. Dagon is set up as a partnership in Canada. The concert promoter will pay Crooktown Management Ltd a fee of £100,000. Crooktown Management Ltd will deduct a 10% commission and pay additional direct costs estimated at £5,000. The residue will be paid to Dagon. Dagon anticipate incurring expenses of their own amounting to £25,000 including travel, accommodation and subsistence.

   **You are required to explain the United Kingdom taxation consequences for Crooktown Management Ltd and Dagon.** (7)

Total (25)

5.

1) It is possible for an individual or a company to be resident, by virtue of domestic law, in both of the countries which are parties to a double taxation convention.

   **You are required to explain the provisions ordinarily applicable in double taxation conventions entered into by the United Kingdom to resolve the issue of dual residence of individuals and companies.** (7)

2) It is increasingly common for non-United Kingdom companies and individuals to carry on business activities in the United Kingdom.

   **You are required to explain the provisions ordinarily applicable in double taxation conventions entered into by the United Kingdom which determine whether a United Kingdom tax liability exists on such business activities and how that liability is determined.** (10)

3) Houma Supplies Inc is a United States headquartered company which provides logistics services and is seeking to increase its presence in Europe. Its chief financial officer has heard that there are tax benefits in using the United Kingdom as the location for an international holding company.

   **You are required to advise the chief financial officer on the taxation issues relevant to an international holding company incorporated in the United Kingdom.** (8)

Total (25)

6.

1) Allentown Oiltools plc is a United Kingdom headquartered manufacturer of oilfield equipment. Apart from its corporate headquarters, it has a manufacturing facility in the north of England and a repair workshop in Scotland.

It has the following non-United Kingdom corporate interests:

(a) It owns 100% of the share capital of a company in Australia which manufactures similar equipment for the Asia Pacific market, making use of the products originally developed in the United Kingdom.

(b) It owns 100% of the share capital of a recently set up product research and development company in the Republic of Ireland. It is intended that the manufacturing companies will make use of the products developed by that company.

(c) It owns 100% of the share capital of a company in the United States which acts as the distributor for its products in North America and also has a repair facility in Louisiana. The repair facility regularly draws on the more highly qualified technicians employed in the United Kingdom to assist in the more complex repair processes.

(d) It owns 100% of the share capital of a company in Cyprus which acts as the distributor for its products throughout the Middle East region. Unlike the United States distributor, which receives a commission based on the value of product sold, the Cypriot company buys equipment from the United Kingdom and Australia companies to meet customer demand and sells on to its customers. There is a particular current focus on expanding into the North African market which has not previously been exploited by the company.

(e) It owns 49% of the share capital of a company in China, the other 51% being owned by an otherwise unconnected Chinese company. This company procures spare parts for use by the manufacturing and repair facilities.

(f) It owns 33% of the share capital of a company incorporated in Brazil, the other 67% being owned equally by two Brazilian companies. This joint venture provides logistical services to the oil and gas industry in Brazil. There is an agreement between the companies that Allentown Oiltools plc will receive 55% of the distributable profit of the company.

As well as investing share capital in these companies, Allentown Oiltools plc has also advanced long-term loans and has made a capital contribution to the United States company. The group management is all based in the United Kingdom, except for the engineering director who is employed by the Republic of Ireland subsidiary. Head office departments in the United Kingdom are also responsible for legal, human resources and taxation advice round the world, utilising local external advisers as required.

**You are required to discuss the transfer pricing issues relevant to Allentown Oiltools plc and to make appropriate recommendations as to how such prices should be determined.** (20)

2) The United Kingdom authorities are prepared to enter into Advance Pricing Agreements with multinational companies.

**You are required to explain the rules and procedures applicable to such Agreements.** (5)

Total (25)

7.

1) Bryansville Consultants Inc is a United States transport consultancy. It considers that there are substantial opportunities for it in the United Kingdom market and the chief financial officer has asked to meet you to discuss the tax issues.

He expects that the business will incur losses in the first two or three years as it establishes itself in the United Kingdom but that it should make significant profits thereafter. He is cautious about whether to establish a United Kingdom company immediately or whether initially to operate as a branch until the business is well established. Although he does not think that there will be a need for substantial long-term capital investment, there will be a need for financing for at least two years and it is expected that this will either have to come directly from the separate treasury management company which Bryansville Consultants Inc owns in the United States or through United Kingdom bank borrowing guaranteed by that treasury management company. Thereafter, he anticipates that the company will wish to repatriate most profits to the United States and he wishes to consider how this can be done.

The United Kingdom organisation will train its own staff but there will be both long-term and short-term transfers from the United States. It is envisaged that the start-up team will be in the United Kingdom for between four months and eighteen months but that the senior management will stay for at least five years.

**You are required to prepare notes of the matters to be discussed with the chief financial officer. Reference should be made where appropriate to the double taxation convention between the United Kingdom and the United States.** (19)

2) Walkertown College is a United Kingdom further education institution receiving all of its income from fees charged to students. It requires a new computer system and is about to enter into a contract with a United States computer supplier for a three year lease of computer equipment at an annual cost of £100,000.

**You are required to explain the value added tax issues arising from this contract.** (6)

Total (25)