THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

May 2006

PAPER II

ADVANCED INTERNATIONAL TAXATION

A – UNITED KINGDOM

TIME ALLOWED – 3 HOURS

- You should answer FOUR out of the seven questions.
- Each question carries equal marks.
- Start each answer on a new sheet of paper.
- All workings should be made to the nearest month and pound unless the question requires otherwise.
- Marks are specifically allocated for 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.

1. 1) Beltane Machines Ltd is a UK resident company owned 75% by Mr Allison and 25% by unconnected parties. It trades in the UK in the manufacture of machinery for use in the IT industry.

It has the following transactions:

(a) It sells goods directly to third parties both in the UK and in the Eastern Hemisphere. It also sells goods to a distribution company incorporated in the United States which is responsible for all Western Hemisphere sales. The distribution company is owned 50% by Beltane Machines Ltd and 50% by a US individual who holds its chief executive officer position.

(b) It acquires raw materials from an Indian company owned 25% by Mr Allison's sister and the remainder by unconnected parties. The Indian company has put in place a share incentive scheme under which the sister's shareholding could increase to 55%.

(c) Its financial transactions are subject, when required, to a guarantee issued by BA Guarantees Ltd, a company incorporated in Guernsey and taxed there at a 0% rate. BA Guarantees Ltd is wholly owned by a UK company wholly owned by Mr Allison and its sole activity is the provision of these guarantees.

(d) Research and development activity is undertaken by Beltane Research Ltd owned 45% by Mr Allison and 55% by an unconnected third party. The company has 10 employees and its annual turnover is less than £1 million. Beltane Research Ltd has made losses in its start-up period and it has been agreed that it will double its charge-out rate to Beltane Machines Ltd until these losses have been eliminated.

(e) Beltane Machines Ltd has two wholly owned small manufacturing subsidiary companies in the Asia Pacific region and Mr Allison wishes to involve the local management of these companies more in the success of the group. He has accordingly decided to grant the local managers share options in Beltane Machines Ltd.

You are required to explain the impact of the United Kingdom transfer pricing legislation on these transactions. (10)

2) The United Kingdom's transfer pricing legislation makes specific reference to the transfer pricing guidelines issued by the OECD.

You are required to explain the guidance given by the OECD towards the setting of appropriate transfer prices. (10)

3) The authorities, either in the UK or overseas, may successfully contend that a transfer pricing adjustment should be made.

You are required to explain the entitlement of a UK company on the other side of such a transaction to make a corresponding adjustment in the computation of its taxable profit. (5)

Total (25)

2. 1) The M&C Consultancy Company, a United States business, is considering setting up business in the UK for the first time. It is uncertain as to the likely success of the venture and does not want to go through the process of incorporating a local entity until it can be sure of the scale and success of the activity. The nature of the business is such that, especially in the early stages, there will be considerable flexibility as to the duration of presence of consultants in the UK. Initially, the consultants will be American citizens but it is possible that some UK residents might be employed although they would be required to be flexible in working abroad if necessary. The chief financial officer thinks that it may be worth renting a property in the UK but it is possible that the company's personnel will ordinarily work from clients' premises.

You are required to explain the liabilities to both direct and indirect tax in the UK which may arise from these proposals. (17)

2) Greenridge Aero Ltd, a UK resident company, carries on the business of repairing aero engines in the UK. Some of the parts required to undertake the repairs are sourced from outside the UK and some of the engines for repair are brought in from outside the UK and then returned after the repair has been completed.

You are required to explain the extent to which a liability to UK customs duties may be incurred as a result of these transactions and what arrangements may be made for the payment thereof. (8)

Total (25)

3. 1) The concept of domicile may be relevant in determining an individual's liability to tax in the UK.

You are required to explain how domicile is determined and the circumstances in which it is important in determining liability to tax. (13)

2) In the absence of specific legislative provisions to the contrary, it would be open to taxpayers to avoid UK tax by transferring assets overseas and arranging for any income arising therefrom to be paid to persons outside the UK taxing jurisdiction.

You are required to explain the operation of the legislative provisions designed to counteract such avoidance, referring to relevant statute and case law. (12)

Total (25)

4. 1) Northcote Holdings Ltd is a UK incorporated company, 60% of which is owned by West End Investments Ltd, also a UK incorporated company, 25% by Mr Dee, a UK resident, and 15% by Don Ltd, a UK investment company.

Northcote Holdings Ltd has a number of shareholding interests, including the following:

(a) It owns 100% of Craigton Insurance Ltd, a captive insurance company incorporated in the Isle of Man where, following the making of an appropriate election, it has been agreed that it will pay Income Tax of 23% of its accounting profit.

(b) It owns 100% of NH Services Ltd, a management services company incorporated in Cyprus (where the tax rate is 10%) but providing its services from an office in the United Arab Emirates where no tax is charged. NH Services Ltd employs the Group management overseeing the Middle East and Asia Pacific regions.

(c) It owns 100% of Springfield Investments Ltd, a company incorporated in the Cayman Islands where no tax is charged. That company sub-licenses the Group's intellectual property to third party customers round the world. It does not itself own any of the intellectual property but licenses it from the various Group company holders without payment. There is one employee based in the Cayman Islands on a full-time basis to deal with intellectual property issues.

(d) It owns 100% of Northcote Engineers Pte Ltd, a company incorporated and trading in Singapore (where the tax rate is 20%). That company operates an equipment overhaul business and undertakes work for both Group companies and third parties. During the year that company sold surplus trading property generating a capital gain of £250,000.

(e) It owns 100% of NH Finance Ltd, a Group Treasury company incorporated and trading in the Republic of Ireland (where the tax rate is 12.5%). That company employs the Group Treasurer and his department, all of which are located in Dublin.

(f) It owns 100% of Northcote BV, a Dutch incorporated company which carries on a distribution business producing about 20% of its profit each year as well as owning a number of trading subsidiaries elsewhere in the European Union from which dividends are received annually amounting to about 80% of Northcote BV's profit.

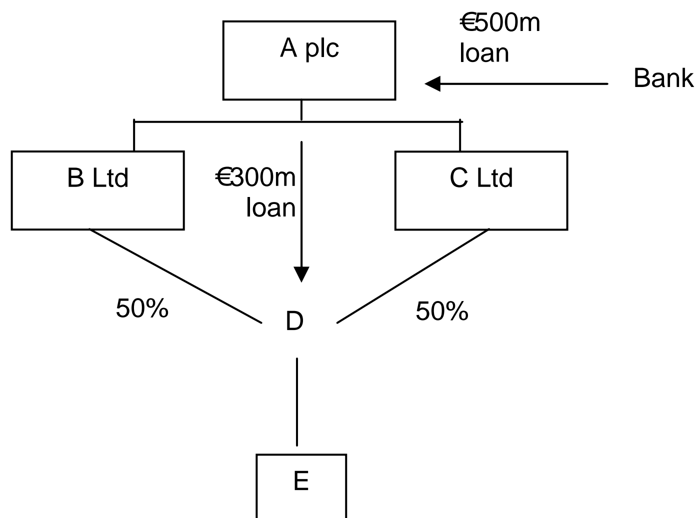
You are required to explain the application of the UK controlled foreign company rules to these companies. (13)

2) The UK controlled foreign companies rules have been subject to challenge at the European Court of Justice.

You are required to explain the rights of the European Court of Justice to consider domestic tax legislation, including examples of decisions which have arisen from the UK's tax provisions. (12)

Total (25)

5.



The A plc group recently acquired E, a company incorporated and resident in country F. The price paid for E was €500m and was paid by D, an entity formed under the laws of country F. D borrowed €300m from A plc and also received €100m from each of its members, B Ltd and C Ltd, via capital contributions. B Ltd and C Ltd had each received €100m from A plc in return for an issue of shares which they used to fund their capital contributions to D. A plc borrowed the entire €500m from a third party bank.

A plc, B Ltd and C Ltd are all UK incorporated and resident companies and A plc owns 100% of both B Ltd and C Ltd.

D and E are members of a tax group in country F and interest expense of D is set against taxable profits of E.

The main characteristics of D are:

1) It is not a legal entity separate from its members.

2) Its members have limited liability for debts of D.

3) D does not own assets in its own name; these are owned by B Ltd on behalf of all members of D and D itself.

4) The profits and losses of D are allocated to each member according to accounts prepared at the end of each year (although losses are restricted to each member's capital contribution and other reserve accounts).

5) Each member is unable to sell or transfer its membership without the consent of all other members.

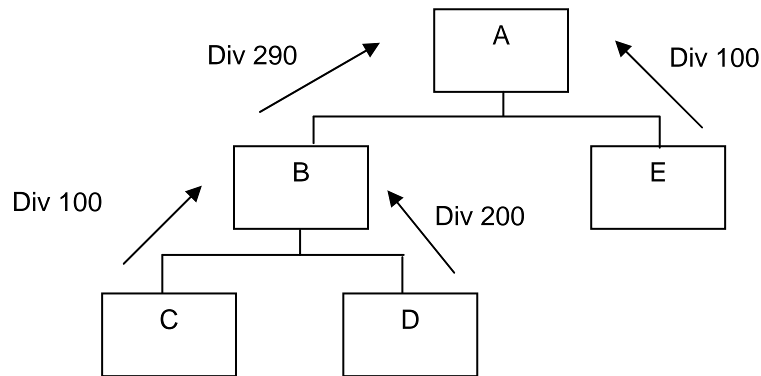
6) B Ltd takes all management decisions in relation to the business of D but these decisions affect both itself and C Ltd.

You are required to describe the UK tax implications of the above structure. Include within your analysis the likely characterisation of D for UK tax purposes using case law and HM Revenue & Customs guidance to support the analysis and conclusions. Also include the implications (if any) of the Avoidance through Arbitrage provisions, as well as any other UK Corporation Tax, Stamp Duty and VAT issues.

(25)

6.

1)



A is resident in the UK.

B, C, D and E are resident outside the UK, and are all resident in different countries. B and E are resident in different Member States of the European Union.

The results of C and D in recent years have been:

C

	Year 1	Year 2	Year 3
Profit before tax	100	80	150
Tax per accounts	(40)	(20)	(20)
Profit after tax	60	60	130
Tax paid	60	20	30

D

	Year 1	Year 2	Year 3
Profit/(loss) before tax	150	(50)	300
Tax per accounts	(20)	----	(90)
Profit after tax	130	(50)	210
Tax paid	20	----	60

In year 3, C declared a dividend of 100, although B received only 90 as the dividend was subject to withholding tax of 10 in country C. D also declared a dividend in year 3, of 200, which was not subject to withholding tax. Neither dividend was specified as being out of particular profits. Both dividends were exempt from tax in company B.

In year 4, B declared a dividend of 290 to A, which was specified as paid out of the profits of year 3. The only transactions B had in year 3 were the dividends from C and D which were recorded as income of 300 and tax of 10 (being the withholding tax).

In year 4, E declared a dividend of 100 out of its entire post-tax profits of year 3. E had paid 20 of tax in respect of its year 3 profits. E is a controlled foreign company for UK tax purposes and does not satisfy the CFC exempt activities test, excluded countries regulations, public quotation exemption or the motive test.

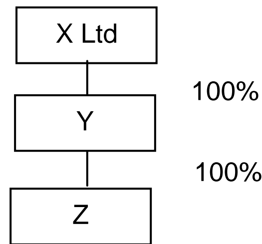
Prepare a UK tax computation for A showing its UK Corporation Tax liability on the B and E dividends, together with any double tax relief and eligible unrelieved foreign tax available. Assume that none of the B, C or D dividends were paid to satisfy the acceptable distribution policy exemption from a CFC apportionment.

(18)

Continued

6. Continuation

2)



X Ltd is UK resident. Y and Z are non-UK resident and are resident in the same country.

The results of Y and Z for a particular year are:

	Y	Z
Profit before tax	200 (1)	100
Tax per accounts	(30)	(50)
Profit after tax	170	50
Tax paid	30	50

(1) includes the dividend of 50 from Z on which no further tax is suffered by Y.

Z paid a dividend of 50 to Y during the year and Y paid a dividend to X of 170 in the same year. Tax paid was the same as tax per the accounts for both companies.

Y is a CFC that does not pass the CFC exempt activities test, excluded countries regulations, public quotation exemption or motive test. Z is not a CFC.

Compute the UK tax payable in the above scenario. (7)

NB: assume that the UK Corporation Tax rate is 30%.

Total (25)

7. 1) UKCo is a company incorporated and tax resident in the UK. UKCo is 100% owned by Mr and Mrs Smith, who have been married for 10 years.

UKCo owns 100% of the shares in A, a company incorporated and resident in country A (not the UK). A owns a house in country B.

The double tax treaties between the UK and countries A and B, and between A and B, are identical to the OECD Model Convention. Country A operates an exemption system in relation to certain foreign profits and income.

Describe the tax treatment in countries A, B and the UK if A sells the house and distributes the proceeds as a dividend to UKCo. Refer to the position under the relevant treaties as well as UK domestic law. (15)

2) A Inc owns 100% of UKCo (for the avoidance of doubt, a different company from that in 1) above) and UKCo owns 100% of USCo. UKCo acquired USCo in 2003. A Inc is resident in country A (which is neither the UK nor the US). A Inc is quoted on the stock exchange in country A. At least 60% of A Inc's share capital is owned by residents of country A.

In 2006, USCo pays a dividend to UKCo.

Analyse the relevant articles of the double tax treaty between the UK and the US to assess the rate of withholding tax (if any) that the US is entitled to deduct from the USCo dividend. Assume the double tax treaty between country A and the US has a 15% rate of dividend withholding tax. (10)

Total (25)