THE CHARTERED INSTITUTE OF TAXATION

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

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PAPER I

PRINCIPLES OF INTERNATIONAL TAXATION

Suggested answers

Question 1:

This question is founded on a quotation that relates to the interpretation of treaties *generally*. An initial line of inquiry might, therefore, be whether the dual nature of double taxation agreements, which can be viewed from an international and domestic perspective, might influence the approach adopted when questions of interpretation arise. In this respect, reference might be made to case law which is indicative of the likely approach i.e. that in most jurisdictions courts tend in interpreting double taxation agreements to favour the latitude offered by the Vienna Convention on the Law of Treaties with regard to the admissibility and use of interpretative aids (query, however, whether the Convention contemplates access 'to any material which can usefully serve as a guide'). Thereafter, attention should be given to the following issues:

- the attribution of meaning through the interpretative process

- the reasons for the apparent difference between the rules of interpretation applicable to treaties/conventions and the approaches applied to the interpretation of domestic (fiscal) legislation

- the meaning and application of Articles 31-33 of the Vienna Convention on the Law of Treaties. Here, the reference should be made to the types of material which the Convention countenances may be material to the interpretative process

- the utility of various interpretative aids e.g. the Commentaries to the OECD Model Tax Convention on Income and on Capital (the OECD Model)

Credit will be given to answers that specifically relate the discussion of the interpretation of double taxation agreements to the quotation and/or which refer to relevant recent cases from any jurisdiction.

Question 2:

An initial understanding of the notion of double taxation should be shown and together with the importance attached to its prevention/elimination by double taxation agreements. Thereafter, it might be expected that the commonly used definitions of juridical and economic taxation in the international context would be utilised i.e. respectively 'the imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same subject matter and for identical periods' and 'the imposition of taxes in two (or more) states on the same economic transaction, item of income or capital during the same period, but in the hands of different taxpayers'. The components of each definition should be examined in depth.

The latter part of the question presupposes a preliminary analysis of the approach adopted towards double taxation in the OECD Model and an acknowledgement of its emphasis on juridical rather than economic double taxation (credit will be given for comparative observations offered in relation to other Models) followed by a critical assessment of the efficacy of selected articles which purport to deal with the problem of double taxation e.g. Article 9 (transfer pricing adjustments between associated enterprises) and Article 23 (the elimination of double taxation through the exemption or credit methods).

Question 3:

This question juxtaposes the new Article 27 of the OECD Model with the long standing Revenue Rule. Logically, it might be expected that consideration should be given in the first instance to the Revenue Rule in order that the significance of the introduction of Article 27 might be appreciated in context (however, the reverse order of treatment is acceptable).

Initially, an exposition of the Revenue Rule (the non-enforcement of foreign revenue claims) is required together with reference to academic authorities e.g. *Dicey and Morris* and leading cases such as *Government of India v. Taylor* from which the rationale for the rule might be discerned. Some reference should also be made to cases decided in the UK and elsewhere which are illustrative of the operation of the rule in instances where attempts, directly or indirectly, to enforce foreign revenue claims have been denied. The dilution of the rule might be introduced by making reference to, first, the case law exceptions to its operation i.e. where tax claims are made in a cross-border insolvency and where executors/trustees seek to indemnify themselves against foreign revenue authority claims, and, secondly, to cases in which its operation has been diminished through co-operation between states by agreement. Clearly, Article 27 falls within the latter category. The consideration of the substance of Article 27 might be prefaced by a reference to the note to the Article to the effect that its potential operation may be hindered by restrictions may be imposed on the co-operation it envisages by the domestic law, policy or administrative practices of particular states. Thereafter, an examination should be undertaken of the operative paragraphs of the article e.g. to which revenue claims does it relate, the pre-requisites to a request for assistance, the duties placed upon a state to comply with such a request, and circumstances in which the requested state may refuse to comply with a request. Credit will be given for references to other examples of co-operation between states in this area e.g. in the relation to the European Union, the Mutual Assistance for the Recovery of Tax Claims Directive. References to pertinent recent cases, such as *Pasquantino*), will also be rewarded.

A fitting conclusion should be drawn.

Question 4:

This question requires a specific and detailed analysis of the provisions of the OECD Model Agreement on Exchange of Information on Tax Matters (the Model) against the backdrop of the OECD's harmful tax practices project. In relation to the former, the Model's origins have clearly informed its structure and content. Thus, for example, the nature of the duties of the requested state in relation to requests for information are made explicit (Article 5), and specific provision is made for the possibility of tax examinations abroad (Article 6). The materiality of the circumstances in which a request for information may be refused (Article 7) and the parameters of confidentiality (Article 8) should also be alluded to. Credit will be given for references to the comparative (and, arguably, more limited) operation of Article 26 (Exchange of Information) of the OECD Model Tax Convention.

The latter part of the question is more discursive in nature. Nevertheless, it requires the identification and examination of the major objectives of the OECD's work on harmful tax practices with regard to tax havens, which are to be found, initially, in its 1998 Report, "Harmful Tax Competition – An Emerging Global Issue", and thereafter, as modified, in subsequent reports published in 2000, 2001 and 2004; objectives that might be broadly described as encouraging a global fiscal environment in which fair tax competition can take place and where there is a level playing field amongst all countries and jurisdictions. Thereafter, an assessment must be made of the extent to which the Model has furthered these objectives, and, if it has, how its significance should be measured against other 'achievements' of the project e.g. the implementation of "rollback" and "standstill" provisions in relation to harmful tax practices.

Question 5:

Initially, it may be observed that, in principle, the determination of transfer prices by associated enterprises is not inherently unacceptable (in fact, it is reflective of the economic benefits to be derived from membership of a group), but states are concerned to ensure that such determinations are not overly influenced by a desire to take undue advantage of the disparities in the tax systems of states in which the associated enterprises operate. Thereafter, it might be expected that reference would be made to the arm's length principle (appropriately defined) as the yardstick which has been adopted (particularly by the OECD) to assess whether transfer prices between associated enterprises have been manipulated to achieve a tax advantage. At this stage, reference might be made to the origins of the use of the arm's length principle, its presence in Article 9 of the OECD Model (and its UN Model equivalent), the methods used to give effect to it and to the OECD Transfer Pricing Guidelines. Such material provides a useful background to the consideration of the merits and demerits of the arm's length principle, including, in relation to the former its perceived objectivity and widespread acceptance, and in relation to the latter the particular difficulties associated with the methods used to give effect to it e.g. the absence of comparables in many instances (especially in cases involving intangible property), and the ability of states to choose which of those methods to employ in a given case and the fact that the choice made by one state may not coincide with the choice made by the other state.

The consideration of unitary taxation and the concomitant formula apportionment as a viable alternative to the arm's length principle requires a careful analysis of precisely what these notions entail. Each should be carefully defined and focus placed on the principal attribute of a system which utilises unitary taxation and formula apportionment, namely its concentration on the existence and income of the enterprises as a whole in a way that reflects the reality of the relationships between those enterprises. Reference may be made to the utility of such a system in a federal state and to the experience of states in the USA in employing such a system. The potential attraction of such a system may be countered by reference to its perceived disadvantages, including the difficulties inherent in establishing a common understanding of the constituent elements of a unitary business and of the factors germane to the apportionment formula, the need to ensure that any agreed formula provides for the fair allocation of income between developing and developed states, and the problems associated with acquiring the information that is essential to the consolidated approach that such a system envisages.

It is unlikely that the conclusions reached about the view expressed in the statement will be uniform. Credit will be given for reasoned conclusions that draw on recent developments, see, for example, within the EU: the establishment and work of the Joint Transfer Pricing Forum, the adoption of the Code of Conduct relating to the EU Arbitration Convention, and the apparent willingness of the European Commission in its report relating to corporation tax within the EU (2001) to countenance systems of apportionment within its proposals relating to home state taxation and a common consolidated tax base.

Question 6:

This problem relates to various ways in which multinational enterprises may seek to avoid tax and means by which a state, Attractavia, may try to curb what it regards as unacceptable tax avoidance. In this instance, the essence of the anticipated attempt to avoid tax is twofold – first, to 'block' the remission of dividends to Attractavia and, hence, avoid its comparatively high rates of tax on corporate income, and, secondly, to make income (equivalent to the aforesaid dividends) available to parent companies resident in Attractavia in a tax-efficient manner. The problem requires the fiscal viability of these possible arrangements to be assessed with regard to an existing statutory provision in the Attractavian Revenue Code, namely a general anti-avoidance rule (GAAR), and in relation to targeted anti-avoidance measures that may be introduced.

With regard to the potential applicability of the GAAR, it might be expected that consideration is given to its parameters i.e. what does 'arrangements whose only or main purpose is the avoidance of tax' mean, the consequences of its applicability i.e. how is the position of the taxpayer affected if it applies, and to what extent can such a rule be effective outside the domestic context e.g. bearing in mind that the ARD will be dependent, to some extent, for the purposes of assessment and recovery of tax on the information it receives with regard to the activities carried on by the intermediate companies from the state in which those intermediary companies are based. In these respects, reference may be made to the operation of GAARs in states, such as Australia and Canada, and to the difficulties to which they give rise (general judicial anti-avoidance doctrine, such as that prevailing in the USA, may also be alluded to). The discussion of the GAAR may be supplemented by consideration of its relationship with limitation of benefit clauses, if any, included in double taxation agreements entered into by Attractavia with the states in which the intermediate companies are to be found.

With regard to the precautionary specific anti-avoidance measures that may be introduced, attention should focus on the possibility of enacting controlled foreign corporation legislation (CFC legislation) in relation to the holding of the dividends in the intermediate companies, and on the suitability of thin capitalisation rules to deal with the proposed loan arrangement. A clear exposition of the nature and modus operandi of each of these anti-avoidance measures is required, preferably, with reference to the manner in which such measures are applied in particular states. It should also be noted that such measures have not been free from controversy, and, in this regard, reference may be made, for example, to challenges in the ECJ to the UK CFC legislation in *Cadbury Schweppes* and to the German thin capitalisation rules in *Lankhorst*.

Critically, an attempt should be made to apply the substantive law to the facts of the problem and to reach a conclusion as to the efficacy or otherwise of the general and specific anti-avoidance measures discussed.

Question 7:

Initially, this problem raises issues relating to the basis upon which a state may establish the right to tax/jurisdiction to tax corporate profits. In this respect, specific consideration is required as to whether a right to tax the profits of HCS Ltd may be vested, respectively, in the states of Vindaloo, Bhuna and Korma. Thereafter, attention should be directed towards the manner in which competing rights to tax, if any, may be resolved. The position of each these states might be approached as follows:

Vindaloo: HCS Ltd is incorporated in this state. The domestic law of Vindaloo may provide that such incorporation makes HCS Ltd a national and/or resident of that state. As a consequence, Vindaloo may claim to tax HCS Ltd on its worldwide profits.

Bhuna: In the absence of incorporation in Bhuna, Bhuna's right to tax will be dependent on whether under its domestic law HCS Ltd can be regarded as resident in Bhuna on the basis of other criteria. In this respect, domestic law may provide that HCS Ltd is resident if its central management and control/ effective place of management is situated in Bhuna. If so, the meaning of these phrases should be explored with a view to ascertaining whether on the facts relating to its Board of Directors and executive committee HCS Ltd so qualifies.

Korma: Korma's prospective right to tax will be dependent on whether HCS Ltd's proposed activities (initially, marketing and maintenance of stock) in Korma constitute a permanent establishment within the meaning of Article 5(1) of the OECD Model either on the basis that it will create 'a fixed place of business through which the business of the enterprise is carried', but note Article 5(4). An agency permanent establishment is possible based on the presence of the director in Korma (query: what is the meaning of 'seconded'? and, in what circumstances, is the director's position for tax purposes (is he an employee; is he a dependent agent?) governed by Article16?)

In view of the existence of double taxation agreements between each of these states, which are based on the OECD Model, in relation to the resolution of any competing rights to tax between Vindaloo and Bhuna based on dual residency reference should be made to the tie breaker rule in Article 4(3) of that model (place of effective management will prevail), whilst for any competition that may arise between either

Vindaloo or Bhuna and Korma reference should be made to Article 23. Disputes as to whether a permanent establishment has been established in Korma may be resolvable through the mutual agreement procedure (MAP).

Critically, an attempt should be made, as intimated above, to apply the substantive law to the facts of the problem and to advise HCS Ltd accordingly.