THE CHARTERED INSTITUTE OF TAXATION

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

May 2007

PAPER II

ADVANCED INTERNATIONAL TAXATION

A – UNITED KINGDOM OPTION

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) The recent decision of the Special Commissioners in the case of *Gaines-Cooper v Revenue and Customs Commissioners* in relation to residence and domicile has attracted considerable attention among tax advisers and in the professional press.

You are required to explain the issues arising in the case and discuss its significance in relation to questions of residence and domicile in the United Kingdom. (9)

2) There has also been significant recent case law in relation to the residence of companies for UK taxation purposes.

You are required to explain the rules governing the residence of companies for UK taxation purposes with particular reference to the significance of the decision in *Wood and Another v Holden*. (8)

3) Millennium Investments Ltd is an investment company managed and controlled in the Cayman Islands and not subject to any form of Income Tax in that country. It has always made up its accounts to 31 December. It was incorporated on 1 January 2000 with the following four shareholders subscribing for a total of £1 million of ordinary share capital. The shareholders are otherwise unconnected and they have at all times been resident in the United Kingdom:

- Timeless Ltd, a company incorporated in the United Kingdom, owning 25% of the shares.
- Mrs Collum, who is United Kingdom resident and domiciled, owning 40% of the shares.
- Mr Dougal, who is resident in the United Kingdom but domiciled in Canada, owning 25% of the shares.
- Mr Richmond, who is United Kingdom resident and domiciled, owning 10% of the shares.

On the day of incorporation Millennium Investments Ltd purchased a portfolio of shares as an investment for £3 million. It sold these shares on 1 July 2002 for £6 million. It subsequently declared two dividends, each of £1 million, on 30 November 2004 and 30 November 2006, both stated to be from the gain on the sale of these shares. The first change in shareholding since incorporation occurred on 28 February 2007 when Timeless Ltd sold 60% of its shareholding in Millennium Investments Ltd to Mr Richmond.

You are required to explain, with calculations, the United Kingdom tax consequences of these transactions. (8)

Total (25)

2. 1) You are the tax manager of Alpha plc, a large United Kingdom headquartered multinational group. It has identified Beta Ltd as an acquisition target and the due diligence team has identified that transfer pricing may be an issue which requires to be reviewed. You have been made aware of the following information:

(a) Beta Ltd has its group headquarters in the United Kingdom. It has various subsidiary companies and is also a participant in joint ventures with one or more otherwise unconnected parties, the interests in the joint ventures ranging from 25% to 50%. The subsidiary and joint venture companies are located in various jurisdictions around the world.

(b) The primary activity of the Beta Ltd group is the manufacture of aircraft parts. Manufacturing is carried on in several jurisdictions, including the United Kingdom. Some sales are made directly to the ultimate customers, some are made via unconnected agents who are remunerated on a commission basis and some are made using regional distribution subsidiaries which may take ownership of the goods and sell them on or may act on a commission basis.

(c) New product development by the Beta Ltd group is carried out in the United Kingdom. This is under a contract with Gamma Ltd, a subsidiary company incorporated in Bermuda which commissions the development, registers any intellectual property in appropriate locations and licenses this to the various manufacturing companies. Gamma Ltd's development activity is funded by way of an interest-free loan from Beta Ltd.

(d) Beta Management Services Ltd is a United Kingdom subsidiary of Beta Ltd and provides head office services to the group companies, including legal, financial, human resources and public relations services. Each subsidiary is charged a fixed fee for these services, which has been unchanged for at least three years and covers in total about 50% of Beta Management Services Ltd's costs.

(e) Senior management of some of the overseas subsidiaries have been permitted to participate in the Beta Ltd employee share option scheme.

(f) The due diligence team has made some initial enquiries concerning inter-company pricing arrangements and has been told that the rates were set by the previous financial controller who left the company three years ago. No record of his workings can be found.

You are required to explain the transfer pricing issues which arise from a United Kingdom viewpoint. Your answer should include relevant discussion as to the methodology of determining an appropriate price. (15)

2) It has been suggested that Alpha plc consider entering into Advanced Pricing Agreements to reduce the likelihood of transfer pricing disputes in the future.

You are required to explain the rules and procedures applicable to Advanced Pricing Agreements in the United Kingdom. (5)

3) You have been advised that various UK companies within the Alpha plc group have incurred VAT in other European Union countries and that various foreign companies in the Group, both from the European Union and otherwise, have suffered United Kingdom VAT on costs incurred from United Kingdom suppliers. You have been asked whether such VAT may be recoverable.

You are required to explain the advice you would give on VAT recovery. (5)

Total (25)

3. 1) GF (UK) Ltd has recently been incorporated in the United Kingdom to carry out financial services business. It is a subsidiary of GF, a company incorporated in Abu Dhabi. Mr Masoud has been appointed as the finance director of GF (UK) Ltd and has asked to meet with you to discuss various issues affecting the taxation of employees who will be working in the United Kingdom.

It is intended that a significant number of employees will be transferred or seconded from Abu Dhabi to the United Kingdom. They will be working in the United Kingdom for periods of between three months and five years. They will be provided with accommodation at the company's expense and paid a daily allowance to cover subsistence and other costs. Some of these employees will rotate between the United Kingdom and Abu Dhabi (where there is no personal income tax) working for four weeks in each location.

Some of these employees will be entitled to bring their families with them and the company intends to pay for the families' travel at the beginning and end of the assignments and also for three return journeys home each year for vacation.

GF is a quoted company on the Abu Dhabi Securities Market and it has granted options over shares to various of the Group's senior employees including some of those who will be assigned to the United Kingdom. Further options are likely to be granted in the future.

Mr Masoud has advised you that GF traditionally pays large bonuses to its senior employees and would wish to keep these outside the charge to United Kingdom tax and National Insurance. As a general rule, the Group would not wish employees to be disadvantaged by the assignment and understands that this may be achieved through tax equalisation, a concept he has asked you to explain. He has also asked if payment of remuneration through a non-United Kingdom company will avoid having to account for PAYE and National Insurance.

There is no double taxation or social security convention between the United Kingdom and Abu Dhabi.

You are required to make notes of the matters that you would discuss with Mr Masoud. (20)

2) Mr Masoud has lived continuously in London for the last fifteen years but is considered to have retained his tax domicile in Dubai where he was born and where his family still lives. He has been advised that he should verify his Inheritance Tax position in the United Kingdom and has asked for your comments. He has confirmed that he owns the following assets:

(a) A house in London used as his principal private residence.

(b) Two apartments in Dubai, one of which is occupied by his family and the other of which is let.

(c) Bank accounts with the Royal Bank of Scotland, held at branches in London and Guernsey.

(d) Shares in Baskakov, which is listed on the London stock exchange but is incorporated and controlled and managed in Russia.

You are required to comment on Mr Masoud's Inheritance Tax position. (5)

Total (25)

4. A Inc recently acquired UK Target. The acquisition was effected through UK Newco which received cash of $100 million in exchange for an issue of shares to A Inc, and cash of $200 million as a loan from UKP. UK Newco used the $300m to acquire 100% of the shares of UK Target from an unrelated party. UK Target is expected to be profitable going forward.

A Inc is a company incorporated and resident for tax purposes in Country A (not the UK).

UK Target and UK Newco are both companies incorporated and tax resident in the UK.

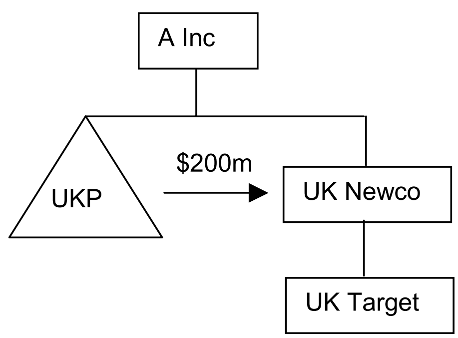
UKP is a partnership registered in the UK whose only activity is the loan made to UK Newco. A Inc is the majority partner in UKP, the other participant being an unconnected third party also resident in Country A.

UKP is regarded as a (UK) taxable entity for tax purposes in Country A; Country A does not therefore tax profits of UKP as they arise.

The double tax treaty between the UK and Country A is identical to the OECD Model Convention.

The loan from UKP to UK Newco is for a term of five years, is interest bearing and is denominated in a currency other than sterling.

The legal structure after the acquisition is as follows:



You are required to describe the UK tax implications of the acquisition and the ongoing structure, covering Corporation Tax, Income Tax, Stamp Duty and VAT.

(25)

5. UK2 recently restructured the ownership of its operations in Country B. Before the restructuring, UK2 owned 100% of the shares of B1 and B2. The restructuring involved the following two steps:

   1) B1 paid a dividend of $50 million to UK2

   2) UK2 transferred the shares of B1 to B2 in exchange for an issue of new shares and a new loan note (face value $400 million)

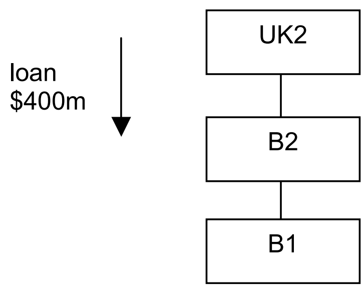
   After the restructuring UK2 owned 100% of B2, B2 owned 100% of B1, and B2 owed $400 million to UK2.

   UK2 is a company incorporated and tax resident in the UK.

   B1 and B2 are companies incorporated and tax resident in Country B (not the UK or any other Member State of the European Union).

   The double tax treaty between Country B and the UK is identical to the OECD Model Convention.

   The legal structure after the restructuring is as follows:



   You are required to describe the UK tax implications of the above restructuring, covering Corporation Tax (including Treasury consent), Stamp Duty and VAT, and detailing any conditions or requirements to satisfy any relevant reliefs that may be available. (25)

6. UK3 owns company A and company C, and A owns company B.

   A is a holding company whose only activity is owning 100% of B, although it also pays interest to C.

   B carries on the following activities:

      Providing installation and support services in relation to software sold by other companies within the UK3 worldwide group; and

      Lending surplus cash to UK3

   As B has been in existence for many years the loan to UK3 is significant and represents 60% of total assets shown on the latest balance sheet of B (it was 50% last year, and lower in earlier years). Interest income on the loan was slightly less than the operating profit from the other activity (and was lower than operating profit in earlier years) but is projected to be higher in future years as more cash is loaned back to UK3.

   Some of the installation and support services are provided directly to third parties, and some are contractually provided to other group companies. Revenues are therefore earned directly from both third parties and group companies. The customers (third party and group) are a mix of UK and non-UK residents. B employs 300 people who provide these services.

Continued

6. *Continuation*

A has never paid a dividend to UK3. B pays dividends to A each year.

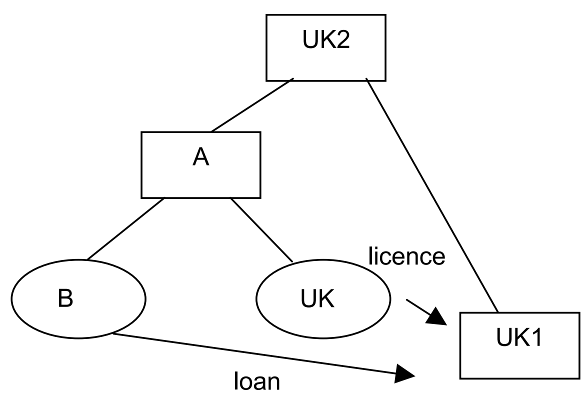
UK3 is incorporated and tax resident in the UK.

A and B are both incorporated and tax resident in Country B (not the UK or any country listed in the Excluded Countries Regulations SI 1998/3081). A files a consolidated corporate income tax return on behalf of A and B together, and pays corporate income tax on the combined taxable profits of the two companies.

C is resident in country C (not the UK).

You are required to describe the UK controlled foreign companies treatment of A and B (NOT C) including any reliefs that may be available from a CFC apportionment and referring to HM Revenue & Customs guidance where relevant. (25)

7.



A, a company resident in Country A, has permanent establishments ("p.e.'s") in two countries, Country B and the UK.

The p.e. in the UK owns intellectual property and licenses this to UK1. UK1 pays royalties to the UK p.e. under this licence agreement.

The p.e. in Country B lends funds to UK1 and UK1 pays interest under this loan to the p.e.

A pays dividends to UK2 sourced from profits generated by the two p.e.'s.

A and UK1 are 100% owned by UK2.

UK1 and UK2 are companies resident in the UK.

Double tax treaties exist between the UK and Country A, the UK and Country B, and Countries A and B. These treaties are all identical to the OECD Model Convention.

You are required to describe:

1) **The UK Income and Corporation Tax implications for A, UK1 and UK2 of the above transactions, referring to the OECD Model Convention where appropriate.** (22)

2) **The allocation of taxing rights of the p.e.'s between Countries A and B, and relief for UK withholding tax on the interest paid to the p.e. in Country B, under the OECD Model Convention assuming that Country A adopts the exemption method of eliminating double taxation.** (3)

Total (25)