THE CHARTERED INSTITUTE OF TAXATION

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

Specimen Examination Paper

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) Fort Bend Equipment Ltd is a UK incorporated and tax resident company whose trade is that of leasing and maintaining industrial equipment. Its activities have so far been concentrated in the United Kingdom except for the appointment of two independent agents to represent the company, both based in countries with which the UK has double taxation conventions which follow the OECD model. The directors now consider that it is essential that the company expand rapidly into overseas markets where they consider that there are substantial growth opportunities, especially in Africa and Latin America.

Mr Thomas, the managing director, explains that the company wishes to set up servicing and sales facilities in a number of countries. Head office functions will continue to be carried out in the United Kingdom. Local commercial conditions will determine whether the leasing activity is conducted by transferring the ownership of the equipment to the local facility and entering into the lease from there or whether the local facility will merely introduce the customer to the UK company who will enter into the lease directly.

Mr Thomas understands that it will be possible to trade in the various locations either as a branch of the UK company or as a locally incorporated subsidiary. He has also been told that companies trading overseas often set up an international holding company to hold the overseas investments.

Mr Thomas has asked to meet you to discuss the United Kingdom corporate tax consequences of the company's proposals and to find out the tax issues of which the company should be aware.

You are required to explain the advice that you would give to Mr Thomas.

(15)

2) At the meeting with you, Mr Thomas also explains that it is the company's intention to use several United Kingdom employees to assist in the set-up of the overseas operations. No decision has been made on the duration of these overseas engagements. Mr Thomas wishes to have some general guidance on the tax consequences of such assignments.

You are required to explain the advice that you would give to Mr Thomas.

(10)

Total (25)

2. 1) There has been much publicity in recent years relating to the tax advantages which are perceived to arise to an individual who is not domiciled in the United Kingdom.

You are required to explain the extent to which there are United Kingdom tax advantages to be gained from being domiciled outside the United Kingdom.

(10)

2) An individual not resident in the United Kingdom is liable to tax under Case III of Schedule D on interest which has a United Kingdom source.

You are required to explain, by reference to case law and Inland Revenue practice, the circumstances under which interest will be considered to have a United Kingdom source.

(7)

3) Mr Espineira is UK resident and ordinarily resident but not UK domiciled. The following information about Mr Espineira's affairs is held in respect of the year ended 5 April 2003:

1) He received the State retirement pension of £5,000.

2) He received a pension of £30,200 from his former UK employer. PAYE of £10,500 was deducted.

3) He received net dividends from UK companies of £18,000. These dividends were paid directly to his bank account in Jersey.

4) He received dividends from a foreign company of £7.500 (net of 25% foreign taxes). These dividends were paid directly to his bank account in Jersey.

5) He was the sole beneficiary of a trust resident for tax purposes in the Isle of Man. He received a distribution of £10,000 from the trust, arising from the sale of UK quoted shares for £30,000 in September 2001, the shares having been acquired in September 1999 for £8,000.

6) He made a Gift Aid donation of £1,000 (net) to his local church.

You are required to compute the tax payable by Mr Espineira for the year ended 5 April 2003.

(8)

Total (25)

3 1) Sheldon Enterprises plc is the United Kingdom resident parent company of a group of companies which manufactures and sells motor car parts on a worldwide basis. You have been asked to review the applicability of the controlled foreign companies legislation to the Group and, in particular, to comment on the following:

a) Sheldon Middle East Ltd is incorporated in Jersey as an exempt company which pays no tax there. Its trade consists of manufacturing parts in the United Arab Emirates where there is no corporate taxation.

b) Sheldon Asia Pacific Ltd is incorporated in Singapore and acts as the holding company for various companies incorporated in Pacific Rim countries. These companies include both manufacturing companies and companies which distribute the manufactured parts in various territories.

c) Sheldon Insurance Ltd is a captive insurance company based in Guernsey. Under the Guernsey tax regime, where the calculation of taxable profit may be assumed to be identical to that in the UK, it has elected to be taxed at a rate of 23%.

d) Sheldon Consultants Ltd is incorporated in the British Virgin Islands where there is no corporate taxation. It has several employees at its office in the British Virgin Islands who provide accounting and IT consultancy assistance to the group companies located in the Americas.

Sheldon Middle East Ltd, Sheldon Asia Pacific Ltd and Sheldon Insurance Ltd are all direct subsidiaries of Sheldon Enterprises plc. Sheldon Consultants Ltd is a direct subsidiary of Sheldon Americas Inc which is the Group's holding company for the Americas and is incorporated in the United States.

You are required to comment on the application of the controlled foreign companies legislation to these circumstances. (12)

2) Yesbee Ltd, a UK tax resident company, has a 31 December year end and has always paid tax at the full rate of Corporation Tax. Yesbee Ltd has been subject to a CFC direction and apportionment for 2000 in relation to chargeable profits of £100,000 of Trebee NA for Trebee NA's accounting period ended 31 December 2000. Trebee NA is a wholly owned subsidiary company which is resident for tax purposes in the Netherlands Antilles. Trebee NA has paid tax of £10,000 in the Netherlands Antilles for 2000, which qualifies as creditable tax for UK purposes.

During Yesbee Ltd's accounting period ended 31 December 2003, it is expected that Yesbee Ltd will receive a dividend of £50,000 declared by Trebee NA, distributed wholly out of Trebee NA's profits available for distribution for the period ended 31 December 2000 of £115,000. Although it has significant cash resources, Trebee NA has been dormant since that date and has made neither a profit nor a loss since that period as all interest received has been covered by administrative expenses. It is understood that the dividend will not bear withholding tax.

You have been advised that, alternatively, Yesbee Ltd may sell Trebee NA for £3 million during 2003 without paying a dividend. Yesbee Ltd has no other sources of foreign income and its basis in Trebee NA for chargeable gains purposes is £100,000.

You are required to prepare a report setting out the tax consequences of these alternative courses of action, including computations of any tax payable.

(13)

Total (25)

4. 1) Your client is eSell Inc a US tax resident corporation, which has a UK website on which it advertises and sells music to UK purchasers in both CD and MP3 format. Orders can be placed and completed on the website and it is expected that they will amount to at least £1 million per annum, both to individuals and to businesses. You are informed that the computer server, on which the website is to be operated and hosted, will be physically located in the UK. The server may be owned by eSell Inc or provided for use by an independent UK based internet service provider.

You are required to prepare a report setting out the United Kingdom tax issues faced by eSell Inc, in relation to:

(a) Corporation Tax. (8)

(b) Value Added Tax. (8)

2) **You are required, by reference to appropriate statute and case law, to explain the circumstances which will cause a company to be considered to be resident for tax purposes in the United Kingdom.**

(9)

Total (25)

5. 1) You have been asked to advise Valley Breweries, Inc., a United States brewer. It is considering the acquisition of the Wildside brewery, located in the north-east of England and currently operated through Wildside Ltd, a long-established family company. The management of Valley Breweries, Inc. is currently considering how the acquisition should be structured and have asked you to set out the UK tax advantages and disadvantages of buying the company or buying the assets of the business from Wildside Ltd and operating as a branch of Valley Breweries, Inc. in the United Kingdom.

You are required to explain the advice which you would give to the management of Valley Breweries, Inc.

(15)

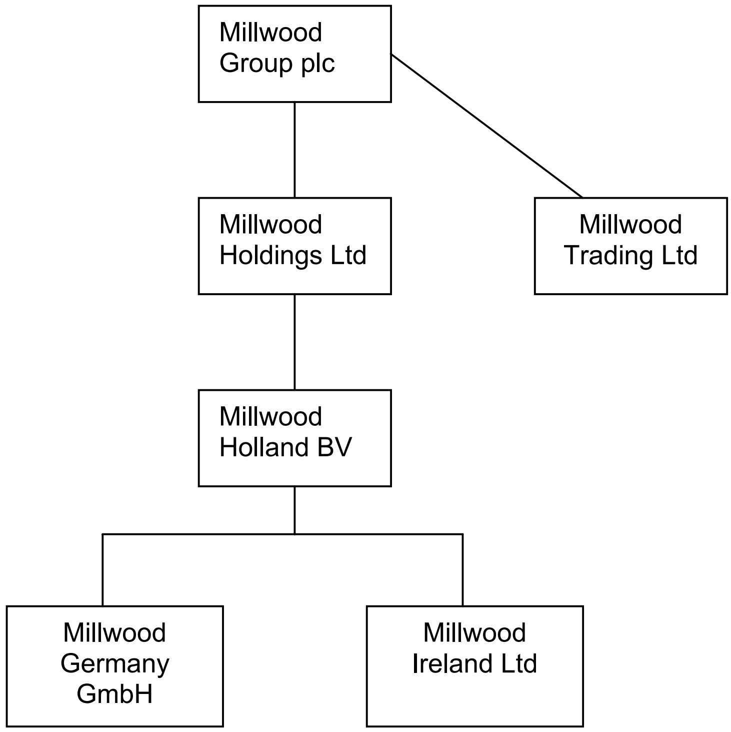
2) Kelimutu Inc is resident in the US for tax purposes and does not carry on a trade in the UK. It has for several years owned 100% of the issued share capital of Labuan Holdings Ltd, a United Kingdom company which owns 100% of the issued share capital of Flores Property Ltd, a United Kingdom property investment company. Labuan Holdings Ltd acquired Flores Property Ltd from a third party vendor in January 1998 for its then market value of £5 million. The purchase was funded by Kelimutu Inc subscribing for £5 million of share capital issued by Labuan Holdings Ltd. Flores Property Ltd was valued at £12 million at 30 April 2003.

On 30 April 2003 Labuan Holdings Ltd was placed in members voluntary liquidation. Fourteen days earlier Bajo New Holdings Ltd was incorporated in the United Kingdom as a 100% subsidiary of Kelimutu Inc On 10 May 2003 Kelimutu Inc transferred Labuan Holdings Ltd to Bajo New Holdings Ltd. This transfer was in exchange for shares issued by Bajo New Holdings Ltd to Kelimutu Inc and is with the agreement of the liquidators. Thereafter, Flores Property Ltd was distributed by the liquidators of Labuan Holdings Ltd to Bajo New Holdings Ltd and the liquidation came to an end.

You are required to write a report, setting out the United Kingdom tax consequences of these transactions. (10)

Total (25)

6. 1) Millwood Group plc is the UK parent company of a group with UK and overseas interests. As of 1 January 2003, the group structure is as follows (all shareholdings are 100%):



During April 2003, Millwood Holland BV (resident for tax purposes in the Netherlands) sold Millwood Germany GmbH (a German resident trading company subject to 45% German tax rates) to Millwood Holdings Ltd for cash. Millwood Holdings Ltd (a UK resident holding company) pays for this out of cash borrowed from a third party UK bank. Millwood Holland BV uses the sale proceeds it receives to subscribe for further shares in Millwood Ireland Ltd (an Irish resident trading company subject to a 10% Irish tax rate), which needs cash to expand its Irish operations.

You understand that up to 2000, Millwood has adopted a full distribution policy from its overseas subsidiaries, using Millwood Holland BV to "mix" the German and Irish tax rates.

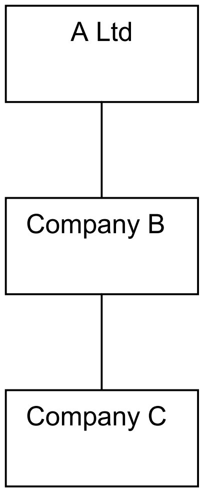
You are required to comment on the UK tax issues surrounding the reorganisation.

(NB You are not required to comment on CFC issues) (11)

Continued

6. *Continuation*

2) An international group has the following structure:



A Ltd is the UK resident 100% parent company of overseas company B and (indirectly) of overseas company C, resident for tax purposes in countries B and C respectively. Both companies B and C satisfy the exempt activities test for UK CFC purposes.

You have been advised that, in the summer of 2003, Company C is intending to pay a dividend to Company B of £1.5 million out of distributable profits that have been subjected to a 50% rate of tax. Company B will then immediately pay the dividend it receives from Company C to A Ltd. There is a 10% withholding tax on dividends paid from country B to the UK. Company B is not taxable in country B on the dividend it receives from Company C and has no other income or expenses. Assume that A Ltd has no other income or expenses and that it pays Corporation Tax at the full 30% rate.

You are required to calculate the Eligible Unrelieved Foreign Tax (EUFT) arising on the dividend paid by Company C to Company B and then by Company B to A Ltd and the UK tax payable in respect of the dividend received from Company B.

(9)

3) **You are required to explain the concept of "tax sparing relief" and outline the circumstances under which it may be available to a United Kingdom resident company.**

(5)

Total (25)

7. 1) You have recently been appointed as the tax manager of Mason Tooling plc, a United Kingdom headquartered manufacturer of machine tools. About 80% of the company's manufactures are exported and a number of distribution subsidiaries have been incorporated in overseas locations. For local reasons the method of operation of these subsidiaries varies; in some cases the distribution company buys the manufactured tools from the UK parent and sells to local customers while in other cases the local subsidiary acts as an agent receiving commission on sales made directly by Mason Tooling plc to the ultimate customer. Mason Tooling plc also supplies the overseas subsidiaries with support from the marketing and legal departments and funds the subsidiaries with loans as and when required.

Mr Walker, the finance director of Mason Tooling plc, has asked you to deliver a talk to the senior operational management on the subject of transfer pricing as it affects the Mason Tooling group. He has asked you to cover the practical issues of determining how transfer prices are set and the administrative and record-keeping requirements.

You are required to draft the notes for your talk.

(20)

2) The United Kingdom's transfer pricing incorporates the possibilities of penalties arising for non-compliance.

You are required to explain the legislation and Inland Revenue practice relating to penalties for non-compliance with the transfer pricing legislation.

(5)

Total (25)