

**UNIVERSITY OF SYDNEY
FACULTY OF LAW**

GRADUATE TAX PROGRAM

EXAMINATION IN AUSTRALIAN INTERNATIONAL TAXATION

JUNE 28, 2007

INSTRUCTIONS:

1. The time for the examination is 2 hours plus 15 minutes reading time. Candidates are **NOT** permitted to write in the examination books during the reading time.
2. This is an **OPEN** book examination. Candidates may take any books and materials whatsoever into the examination room.
3. Candidates must answer **THREE** questions. Each question is of equal value and, if a question has parts, each part is of equal value.
4. The examination is worth 70% of the marks for the course.
5. In each answer, state the further information (if any) that you may need to fully answer the question. If necessary, state any assumptions that you have made in answering a question.

This examination consists of 4 pages, including this cover page. Please be sure that your examination paper is complete.

QUESTION ONE (ANSWER ALL FOUR PARTS – EACH PART IS OF EQUAL VALUE)

1. Land Development Ltd. is a company incorporated, and managed and controlled in Hong Kong. It is listed on the Hong Kong stock exchange and most of its shares are owned by a number of wealthy Hong Kong families. It has conducted a land development business for a number of years in Hong Kong. Land Development decided to develop a tract of land on the Queensland coast. It incorporates three special purpose companies, HK 1, HK 2, and HK 3. Each company is incorporated and managed and controlled in Hong Kong. Land Development holds all the issued shares in HK 1, which in turn holds all the issued shares in HK 2 and HK 2 holds all the issued shares in HK 3. HK 3 acquires and develops the land. After the land is developed, Land Development sells its shares in HK 1. Advise Land Development.
2. The facts are the same as in 1 except that HK 3 is a discretionary trust settled by Land Development with HK 2 as the discretionary beneficiary. The trustee of the trust is Land Development's solicitor. Advise Land Development.
3. Investors Ltd holds all the issued shares in Developers Ltd, which in turn holds five percent of the issued shares in Properties Ltd. The only asset of Properties is Australian land. Developers also holds all the issued shares in Planners Ltd, which holds five percent of the issued shares in Properties. Investors sells its shares in Developers. All companies are non-residents of Australia. Advise Investors.
4. Land Development Ltd holds all the shares in Investors Ltd, which holds all the shares in Properties Ltd. All companies are non-residents of Australia. The only assets of Investors are the shares in Properties and a small amount of cash-at-bank. Properties owns two properties – an apartment building in Hong Kong and a farm in New South Wales. The HK apartment building was acquired in 1990 for \$2m and the farm in 2000 for \$10m. HK Properties has no liabilities. On June 30, 2007, Land Development sells its shares in Investors for \$20m. At that time, the market value of the HK apartment building is \$9m and the market value of the farm is \$10.5m. The only other asset is cash-at-bank of \$500,000. The market value of Investors' shares in Properties on May 10, 2005 is \$15m (comprising \$10m for the farm, \$4.5m for the HK apartment and \$500,000 cash-at-bank). Advise Land Development.

QUESTION TWO (ANSWER BOTH PARTS – EACH PART IS OF EQUAL VALUE)

1. HK News Ltd, a company resident in Hong Kong, publishes the Asia Business Weekly, a weekly magazine of news and analytical articles on business developments in South-East Asia. It is considering a proposal whereby it supplies Business News Pty Ltd, an Australian resident company, with news and analytical articles on South-East Asian business developments for publication in Business News' Australian newspapers. It is proposed that HK News Ltd would receive either a flat annual fee or a fee per item submitted to Business News for publication.

Advise HK News Ltd on the Australian tax consequences of the above proposal.

2. Aussie Ltd, an Australian resident company carrying on manufacturing operations in Australia, proposes to borrow from a Hong Kong bank. The interest income derived by the bank under the loan will be exempt from tax in Hong Kong. The bank has suggested the following arrangement to avoid Australian tax. The loan agreement is to be executed in Hong Kong with loan funds advanced into a Hong Kong bank account opened by Aussie with the bank. The loan funds will be subsequently transferred to Aussie's Australian bank account and used in its Australian operations. Aussie is to lease office space in the same building in which the bank is located. The office's address will be Aussie's address for the purposes of opening the Hong Kong bank account. All the documents relating to the loan will be stored at the office. The office space is serviced by the company managing the building in which the space is located. Advise Aussie.

QUESTION THREE

David has immigrated to Australia from South Africa, together with his wife and three young children. At the time of immigration, David had virtually no assets, but his mother, who remains resident in South Africa, is well off. Just before he left South Africa, his mother gave David US\$20m, which he used to settle on trust in the Seychelles. The trustee is a lawyer friend of David's who lives in the Seychelles and the beneficiaries, as to both income and capital, are entirely discretionary. The default beneficiary, in the event of the trust being wound-up, is the Dutch Reform Church, Durban. David anticipates that the trust will provide him or his wife with funds whenever he asks for them, although the trustee is obliged under the trust deed to consult with David's mother and his cousin, a financial adviser, in South Africa before making any investments or distributions.

For the first three years after David migrated to Australia, no income is distributed by the trust. However, in the fourth year, David's mother requires expensive medical treatment in Switzerland. The trustee, in consultation with

David's cousin, distributes the fourth year's income to David's mother, who pays South African income tax on it.

Advise David.

QUESTION FOUR

Grommit Pty Ltd, a company incorporated, and managed and controlled in Australia, is a manufacturer of surfboards and skateboards. The shares in Grommit are beneficially owned by Midget Carroll, an Australian surfing star of the 1980s. Grommit has established a manufacturing subsidiary in Malaysia ("Malayco"). Malayco has three directors - Jagdish (chair), Schwarz and Sekhon. Jagdish and Sekhon are Malaysian residents who are partners in the Malaysian office of an international chartered accounting firm ("CA Int") that also acts for Grommit in Australia. Schwarz is an Australian resident and a partner in CA Int's Sydney office. All directors' meetings are held in Malaysia with Schwarz participating by a teleconferencing facility. The agenda for the meetings is prepared by Schwarz in consultation with Midget, who also provides voting recommendations on the motions to be put to the meeting. All correspondence between the directors is through CA Int's internal e-mail network. The directors of Malayco invariably follow Midget's recommendations. However, there was one occasion when Sekhon was concerned that a particular motion, if passed, may breach Malaysian company law. This motion was deferred by the board of Malayco and, on subsequent legal advice, was not proceeded with.

Malayco assembles skateboards from parts provided by Grommit and manufactures surfboards from locally acquired raw materials. Skateboards and surfboards are sold to distributors in Malaysia, Hong Kong and Japan. The sales to Malaysian distributors are subject to Malaysian corporate tax. The sales to the Hong Kong and Japanese distributors are structured so that there is no tax in Hong Kong or Japan, and the sales proceeds are paid into Malayco's Hong Kong bank account and are not remitted to Malaysia so that there is also no Malaysian tax on the sales income.

Malayco has invested excess funds in shares in companies resident in Hong Kong, Singapore, Australia, United States and the United Kingdom. All shareholdings are less than 10%. Malayco derives dividends and capital gains in relation to the shares. The dividends and capital gains are paid into Malayco's Hong Kong bank account

Malayco has a bank account in Malaysia on which it earns interest. The interest is taxable in Malaysia at the corporate rate. No tax is paid in Malaysia or Hong Kong on interest earned on the Hong Kong account.

Malayco pays a dividend to Grommit within three months after the end of each year.

Advise Malayco on the Australian tax consequences of the above facts.