

**UNIVERSITY OF SYDNEY
FACULTY OF LAW**

GRADUATE TAX PROGRAM

EXAMINATION IN AUSTRALIAN INTERNATIONAL TAXATION

JUNE 20, 2006

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. Where necessary, state any assumptions that you have made in answering a question.

This examination consists of 6 pages, including this cover page. Please be sure that your examination paper is complete.

QUESTION 1

Aussie Skateboards Pty Ltd, Skaters Pty Ltd, and Tony Sqwark have incorporated a company in Singapore (Singapore Skates) to assemble skateboards for sale in the Asian market. Both Aussie Skateboards and Skaters are companies incorporated in Australia, and Tony Sqwark is an Australian resident. Aussie Skateboards holds 50% of the issued shares in Singapore Skates, Skaters holds 45% and Tony Sqwark holds 5%. There is no common shareholding between Aussie Skateboards and Skaters. Tony Sqwark is Australia's leading skater. He is employed by Aussie Skateboards to market their products, but otherwise has no shareholdings in Aussie Skateboards or Skaters.

The profit and loss statement for Singapore Skates for the year ended June 30, 2006 is as follows –

<u>Income</u>	\$S	\$S
Gross proceeds from the sale of skateboards		1,200,000 ¹
Interest		19,000 ²
Reimbursement of interest withholding tax		1,000 ³
Capital gain		<u>40,000⁴</u>
		1,260,000
Cost of goods sold		<u>500,000</u>
Gross profit		760,000
<u>Expenses</u>		
Administration expenses	100,000	
Entertainment	20,000	
Accountancy fees	50,000	
Legal advice	20,000	
Interest	300,000 ⁵	
Bank fees	10,000 ⁶	
		<u>500,000</u>
Net Profit		<u>260,000</u>

Notes

1. Skateboards are assembled by Singapore Skates. The main components of the skateboards are supplied by Aussie Skateboards and Skaters. Aussie Skateboards supplies the trucks, wheels, bearings, and bolts, and Skaters supplies the decks. The other components are supplied by unrelated suppliers in Singapore. One-third of the sales value is made to unrelated persons in Singapore and is taxed at the normal corporate rate of tax (20%). The other sales are made to unrelated persons in other

Asian countries. The sales are structured so that there is no tax in the country of sale and the sales proceeds are paid into Singapore Skates' Hong Kong bank account. No tax is payable in either Hong Kong or Singapore on these sales.

2. This comprises the following –
 - (a) \$2,000 interest on Singapore Skates' trading account with a Singapore bank. This is subject to the normal rate of Singapore corporate tax (20%).
 - (b) \$8,000 interest on Singapore Skates' Hong Kong account. This is not subject to tax in either Hong Kong or Singapore. The amount has been converted to Singapore dollars in the accounts on the date the amount was paid into the account.
 - (c) \$9,000 interest on a loan by Singapore Skates to Skaters. This amount is net of \$1,000 Australian withholding tax.
3. This is a reimbursement of the Australian interest withholding tax payable on the interest paid by Skaters. Under the loan agreement, Skaters is obliged to reimburse Singapore Skates for the withholding tax.
4. The capital gain arose on the sale of shares in an unrelated company listed on the Singapore stock exchange. The gain is not subject to tax in Singapore.
5. The interest is payable on a loan from a Singapore bank. The loan funds were used to establish the assembling operation in Singapore.
6. The bank fees are incurred in respect of the Singapore trading account (\$S1,000), Singapore bank loan (S\$8,000), and the Hong Kong investment account (\$S1,000). The Hong Kong fees have been converted to Singapore dollars in the accounts at the exchange rate applicable on the date the fees were paid out.

Singapore Skates' balance sheet at June 30, 2006 is as follows –

Assets

	\$S	\$S	\$S
Cash		130,000	
Receivables			
Trade debtors	250,000		
Less provision for doubtful debts	<u>30,000</u>	220,000	
Loan to Skates		100,000	
Inventory		1,000,000	
Plant & Equipment	10,000,000		
Depreciation	<u>2,000,000</u>	8,000,000	
Lease prepayment		<u>550,000</u>	<u>10,000,000</u>

Liabilities

Payables			
Trade creditors		300,000	
Loan from Singapore Bank		4,000,000	
Provision for warranties		<u>200,000</u>	4,500,000

Equity

Issued share capital		5,000,000	
Retained earnings		<u>500,000</u>	<u>5,500,000</u>
			<u>10,000,000</u>

On June 29, 2006, Singapore Skates paid dividends to its shareholders.

Advise Aussie Skateboards Pty Ltd, Skaters Pty Ltd, Tony Sqwark, and Singapore Skates on the Australian tax consequences of the above facts (ignore thin capitalisation consequences).

QUESTION 2

Media (HK) Ltd, a company incorporated and managed and controlled in the Hong Kong SAR, is the holder of various literary, film and video copyrights. Aussie Pty Ltd is a subsidiary of Media and wishes to use the copyrights in Australia.

It has been suggested in relation to each copyright that an agreement be entered into whereby in exchange for a ten year licence of the copyright with respect to Australia (but not the rest of the world) Aussie should pay Media a lump sum of \$1m. This amount will remain outstanding as an interest free loan to be paid off

as revenues of Aussie permit. If, at the end of the ten-year period, the revenues from the use of the copyright are not sufficient to pay the \$1m, the balance of the debt is to be forgiven. When the revenues from a copyright exceed \$1m, the cost of the next copyright licence is to be increased by 90% of the excess, and the amount in excess of \$1m is to be paid immediately.

Advise on the Australian tax consequences of the proposed arrangements for the parties.

QUESTION 3

Rebecca (a New Zealand resident), Celeste (a US resident), and Jenny and Karen (Australian residents) are computer systems experts. They met at a conference in the United States and decided to pool their resources by setting up a limited liability partnership in the United States to provide computer systems advice to clients. The partnership's office is in Seattle where Celeste lives. The partners hold their interest in the partnership in equal shares. A US firm of chartered accountants provides for the day-to-day management of the partnership. The partners hold monthly meetings by setting up an internet chat facility. Any matters not dealt with in a meeting are resolved through e-mail circulation. All decisions are made by majority. The managing partner is rotated each year. Celeste is the managing partner in the current year.

In addition to their capital contribution, the partners have each loaned US\$100,000 to the partnership at 1% interest. The loan agreements were entered into in the United States and the loan funds were advanced to the partnership in the United States.

Most of the partnership's clients are based in the United States. However, on two occasions in the current year, the partnership provided advice to the Sydney branch office of a United States company. Jenny was the partner responsible for providing the advice. The fee income from this advice amounted to less than 10% of the total fee income for the year.

The partnership invests excess funds in US municipal bonds (on which no US tax is payable), shares in US and Australian listed companies, and a 50% shareholding in a US company.

During the current year, the partnership earns fee income, interest, dividends (including a dividend paid by the US company in which the partnership holds a 50% interest), and capital gains on the disposal of shares.

Advise all parties on the Australian tax consequences of the above facts.

QUESTION 4 (ANSWER BOTH PARTS)

1. Manufacturers, an Australian resident company, manufactures widgets. It has established a manufacturing branch in Hong Kong and a sales branch in China. The Hong Kong branch manufactures widgets and transfers them to the sales office in China who sells them to unrelated persons in China. The Hong Kong branch sources all raw materials from unrelated persons in Hong Kong.

During the current year, the Hong Kong branch has sold an item of plant to an unrelated person in Hong Kong for an amount in excess of the acquisition cost. The plant was originally used in Manufacturers' Australian manufacturing operations and was transferred to the Hong Kong branch when those operations were established. It also made a capital gain on the disposal of shares in a Hong Kong listed company.

Advise Manufacturers on the Australian tax treatment of the sales income, and the gains on disposal of the plant and shares.

AND

2. Manufactures Ltd. (a resident of Australia) wishes to raise \$10 million. An arrangement is made with its bank (a resident of Australia) whereby Manufactures draws bills on the bank for \$12 million, such bills being in favour of Manufactures and payable at monthly intervals over twelve months commencing twelve months from the date of the bills. Manufactures then sell the bills on the money market to a resident of Australia at the prevailing discount rate and receives \$10 million. The resident sells the bills to non-resident 1 who, in turn sells the bills to non-resident 2. On maturity the bills are duly presented to the bank by non-resident 2 and paid in full by the bank. The amount paid by the bank in respect of each bill is debited to Manufactures account with the bank which is put in funds by Manufactures by further similar arrangements.

Advise all parties on the Australian tax consequences of the above arrangement.