

UNIVERSITY OF SYDNEY

FACULTY OF LAW

POSTGRADUATE TAX PROGRAM

EXAMINATION IN COMPARATIVE INTERNATIONAL TAXATION

May 14, 2004

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.
4. The examination is worth 60% of the marks for the course. Each question is of equal value and, where a question has parts, each part is of equal value.
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 the question.
6. Fiscalia, the Republic of Fiscalfree, the Kingdom of Utopia, Americus, and Australis are to be treated as separate countries.

The examination paper consists of 5 pages, including this cover page. Please be sure that your examination paper is complete.

QUESTION ONE

Manufacturer Ltd is a resident of Fiscalia. It has developed a new computer technology, which it plans to exploit globally. It has incorporated a subsidiary, Technical Ltd, in the Republic of Fiscalfree, a country that does not impose income tax and which has strict commercial and bank secrecy laws.

Manufacturer has assigned its registered patents for the new technology to Technical, which in turn has licensed the technology to –

- (a) Unrelated companies in the United Kingdom, United States, Germany, Canada, Japan and France; and
- (b) Wholly-owned subsidiaries of Technical in China, Malaysia, and Singapore, which engage in the manufacture of computer equipment.

Under the licensing agreements, Technical is paid royalties as consideration for the grant of the licence to use the patent to manufacture computers. Technical also provides assistance to the licensees in relation to the use of the patents. Information technology experts engaged by Technical provide this assistance over the internet. None of the experts live in Fiscalfree. Technical charges the unrelated licensees cost-plus 100% for the assistance and the related licensees cost-plus 200%.

Manufacturer is the only supplier of key components needed in the manufacture of the computers. These are supplied to licensees through the intermediary of Technical. Manufacturer charges Technical cost-plus 10% for the components and Technical charges the licensees cost plus 200%.

Technical invests its excess funds in debt instruments and shares in publicly listed companies in the United States and the United Kingdom thereby deriving interest and dividends. Technical also receives dividends from its subsidiaries.

Technical does not pay any dividends to Manufacturer.

Technical has three directors: Richard, Graeme and Celeste. Richard is a resident of Fiscalia and also a director of Manufacturer. Graeme and Celeste are residents of Fiscalfree and directors of an unrelated management company engaged by Manufacturer to ensure that the day-to-day management of the Technical complies with its articles of association and Fiscalfree laws (including corporate and commercial laws). Meetings of the Board are held in Fiscalfree each quarter. Graeme and Celeste attend in person, while Richard sometimes attends in person and sometimes attends through a videoconferencing facility. In between meetings, Board business is dealt with by transmittal of e-mails.

In addition to matters of financial policy, the main decisions submitted to the Board relate to the entering into of new licence agreements with unrelated companies. Manufacturer finds potential licensees and undertakes initial discussions (including credit checks), but the final decision as to whether to enter into a licence is taken by Technical's Board.

Advise Manufacturer on the possible tax issues that may arise with its offshore operations.

QUESTION TWO (ANSWER TWO PARTS ONLY)

1. Expatriate, a resident of Fiscalia, is employed by Industrial Pty Ltd, also resident in Fiscalia. She has been offered an assignment to work in Industrial's subsidiary in the Kingdom of Utopia for three years. Industrial has granted Expatriate an option to acquire shares in the company under an employee share scheme. The exercise price is the market value of the shares at the date of grant. At the time of the posting, Expatriate had not exercised the options, but she must do so in the first twelve months of the posting or the option will expire.

Advise Expatriate on the possible tax consequences of exercising the option while posted to Industrial's Utopia subsidiary.

2. Investor Pty Ltd, a resident of the Kingdom of Utopia, is a member of a partnership formed in Fiscalia. The other two members of the partnership are resident in Fiscalia. Each partner has an equal interest in the income and capital of the partnership. Investor has also made a loan to the partnership on which interest is payable.

The partnership has a 28 percent interest in a joint venture company engaged in the development of new technologies in Utopia. The partnership also conducts such activities itself in Fiscalia. During the last tax year, partnership income comprised a dividend from the joint venture company, business profits from Fiscalia, and interest on the partnership bank account in Fiscalia.

Advise Investor on the possible tax treatment, in both Utopia and Fiscalia, of its share of partnership profits and the interest paid by the partnership.

3. Manufacturers Ltd is a company resident in Americus. It manufactures fibbies at its factory in Americus. Fibbies are exported to its sales office in Australis. The unit cost of manufacture (absorption costing basis) is \$10. The transfer price in Manufacturers' accounts of fibbies exported to the Australis sales office is \$15 per unit. This is the price that Manufacturers can sell fibbies at the factory door to an unrelated wholesaler in Americus.

The cost of transportation is \$1 per unit and the cost of selling the goods in Australis is \$1 per unit. The sales office sells the goods for \$25 per unit in Australis.

Advise Manufacturers on the taxation of the profit arising on the manufacture and sale of fibbies. What if the sale price in Australis is \$13 per unit?

QUESTION THREE (ANSWER ONE PART ONLY)

1. How has globalisation impacted on the development of international tax rules?
2. Are tax treaties necessary?
3. Outline the OECD's Harmful Tax Competition Project. How has it impacted on international tax?

QUESTION FOUR (ANSWER FOUR PARTS ONLY)

1. The Kingdom of Utopia has had difficulties collecting income tax from business taxpayers. To improve compliance, it has introduced a minimum tax applicable to all taxpayers carrying on a business. A business taxpayer is liable for a minimum tax equal to 2% of the gross turnover (i.e., gross revenue and net gains) for the tax year. Business taxpayers are also liable for the normal income tax, which is credited against the minimum tax liability. If the normal income tax is equal to or exceeds the minimum tax, no minimum tax is payable. If the minimum tax exceeds the normal income tax, the taxpayer pays the excess. Through this mechanism, business taxpayers effectively pay the higher of the normal income tax or minimum tax liability.

Manufacturer Ltd, a resident of Fiscalia, has a branch operation in Utopia. For the most recently completed tax year, Manufacturer is liable for \$100,000 normal corporate tax and \$120,000 minimum tax in Utopia. What relief might be available in Fiscalia for these taxes?

2. What is cross-border tax arbitrage? Illustrate your answer with an example of a possible arbitrage.
3. What is an exemption with progression?

4. Explain the terms “capital import neutrality” and “capital export neutrality”.
5. What is the purpose of a branch profits tax? Outline the broad design features of the tax.
6. Explain the concept of permanent establishment. What is its purpose in international tax rules?