

UNIVERSITY OF SYDNEY

FACULTY OF LAW

POSTGRADUATE TAX PROGRAM

EXAMINATION IN COMPARATIVE INTERNATIONAL TAXATION

May 20, 2005

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. Republica, Utopia, Fiscalia, Fiscalfree, and the Equitable Republic are to be treated as separate countries.

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

QUESTION 1

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 2 (ANSWER THREE PARTS ONLY)

1. Should base company income be treated as tainted income under controlled foreign companies rules?
2. The Equitable Republic currently uses the foreign tax credit method to relieve double taxation, including the indirect credit in the case of dividends paid to a resident company by a foreign related company where there is a 10% or greater interest (i.e., participation dividends). It is considering moving to an exemption system for participation dividends. It seeks your advice on the relative merits of the indirect credit and participation exemption and whether it should move to the exemption system.
3. Explain the concept of permanent establishment. What is its purpose in international tax rules?
4. X Pty Ltd, a resident of Fiscalia, is considering expanding its operations into Utopia. It seeks your advice as to the relative advantages and disadvantages of using a branch or subsidiary in Utopia for this expansion.

QUESTION 3 (ANSWER BOTH PARTS)

1. Hayton Lewitt, a citizen of Fiscalia, is a professional tennis player. He has a home in Fiscalia where his wife and children live (when not accompanying Hayton on tour) and where he stays during breaks in the tournament season. He also has an apartment in Utopia, which he uses as his base during the tournament season.

Hayton has recently competed in the Republica Open (the national tennis tournament for the country of Republica). Hayton won the tournament and received \$1,000,000 in prize money. During the tournament, Hayton wore the logo of Knike on the sleeve of his tennis shirt. Under his agreement with Knike, Hayton receives \$20,000 for each tournament in which he

wears the Nike logo and a bonus \$20,000 if he wins the tournament. Nike is a company resident in the Equitable Republic. Also during the tournament, he filmed an advertisement for Nike products to be shown on television only in the Equitable Republic. He was paid \$100,000 for appearing in the advertisement.

Discuss the competing claims of Fiscalia, Utopia, Republica and the Equitable Republic to tax each of the amounts referred to above, including under tax treaties.

2. Parent Ltd is a company incorporated and managed and controlled in Fiscalia. It is proposing establishing a subsidiary in Utopia. It has been suggested to Planners Ltd that there may be tax advantages if the subsidiary issues 2 ordinary class shares to Planners for a par value of \$1 each and 1000 A class redeemable preference shares at \$1,000 each.

Advise Planner as to whether there may be tax advantages in using such a financing arrangement.

QUESTION 4 (ANSWER ONE PART ONLY)

1. The Kingdom of Tonga has not entered into any double tax treaties. It seeks your advice as to whether it is necessary for it to start to negotiate tax treaties.

OR

2. "Globalisation, changing international economic conditions and technological development, especially with regard to telecommunications, change the conditions for collecting taxes. Old and established theories and principles of taxation have to be re-evaluated in light of these changes."

Professor Sven-Olof Lodin
President of the International Fiscal Association

Discuss.

OR

3. Critically analyse Professor Bird's international tax order (1988) in the context of the global economy.