

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2017

PAPER 1

PRINCIPLES OF INTERNATIONAL TAXATION

TIME ALLOWED – 3¼ HOURS

This paper has **two** parts: **Part A** and **Part B**.

You need to answer **four** questions in total.

You must answer:

- **At least two** questions in **Part A** (25 marks each)
- **At least one** question from **Part B** (25 marks each)

Further instructions

- All workings should be made to the nearest month and you must use the appropriate monetary currency, unless otherwise stated.
- Start each answer on a new page and clearly indicate which question you are answering. If you are using the on-screen method to complete your exam, you must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.
- Marks may be allocated for presentation.
- The first 15 minutes of the exam consists of reading time. You will be allowed to annotate the question paper during this time; however, you will **not** be permitted to start writing or typing your answer, or use a calculator. The Presiding Officer will inform you when you can start answering the questions.

PART A

You are required to answer **AT LEAST TWO** questions from this Part.

1. **How important is the arm's length principle in international taxation? What difficulties does it present for multinational enterprises? Is there a better approach?** (25)
2. **How do domestic anti-avoidance rules interact with international tax law?** (25)
3. **Provide an overview of the OECD/G20 BEPS initiative, paying particular attention to the impact of BEPS on developing countries.** (25)
4. **Explore how a state might seek to establish the limits of its tax jurisdiction.** (25)
5. **How does the OECD Model Tax Convention deal with the elimination of tax discrimination?** (25)

PART B

You are required to answer AT LEAST ONE question from this Part.

6. Operata Inc (OI) is a successful software company based in Anchiland. OI is highly competitive, and begins developing new products as soon as the previous product is launched. As a result, new OI products are constantly being launched.

OI has historically had minimal overseas operations, but since 2000 has begun to expand its overseas business. In 2000, OI established Operata B-Link (OIBL) in Breeland. As a consequence, OI and OIBL entered into two separate cost contribution agreements:

- a) a cost contribution agreement for future development efforts; and
- b) a technology licence for pre-existing technology.

Under the terms of agreements (a) and (b), OIBL's territory is defined as consisting of Hilland, Montland, Peakland and Vulcland. OI and OIBL agree that the buy-in royalty in relation to agreement (b) will be adjusted in light of factual results, in order to ensure that the royalty reflects the arm's length standard for pre-existing intangible property using the comparable uncontrolled method.

Between 2000 and 2010, OIBL funded its share of research and development costs under agreement (a) and also paid buy-in royalties of \$124 million under agreement (b). The buy-in value was calculated on the basis of a four-year useful life for the relevant pre-existing intangible property, and a declining royalty rate that took into account obsolescence and decay in the pre-existing intangible property. During this time, OI licensed some of its software to unrelated third parties in Anchiland and received royalties of approximately \$1.3 billion over the same period. This software is not identical to that sold by OIBL in the overseas markets of Hilland, Montland, Peakland and Vulcland.

During the period 2000-2010, OIBL was successful in building up significant sales and marketing organisations across Hilland, Montland, Peakland and Vulcland. OIBL recorded expenditure of more than \$1.3 billion on sales and marketing during this period.

OI has been advised that the Anchiland Revenue Authority (ALRA) is considering serving OI with a full disclosure notice in relation to agreements (a) and (b), which would require OI to provide a justification for the methodology it has used to provide appropriate arm's length prices under the two agreements.

OI has also been advised that the ALRA will assign a perpetual useful life to all pre-existing intangible property under technology licences, which conflicts with OI's determination of a four-year useful life under agreement (b). The ALRA will also treat both (a) and (b)-type agreements as effective sales of overseas business to the foreign counterpart.

You are required to:

- 1) **Provide OI with a report which considers the strategy that a business such as OI might adopt, in view of the proposed ALRA approach?** (15)
- 2) **Place the issue of cost-contribution agreements, and buy-in agreements in particular, within the current OECD policy context.** (10)

Total (25)

7. The domestic income tax law of Exogenia, the Exogenian Income Tax Act 2017, provides that corporate residence is to be determined according to one of the following criteria:
- a) Incorporation in Exogenia; or
 - b) Carrying on business in Exogenia with either the company's central management and control in Exogenia, or its voting power controlled by shareholders who are residents of Exogenia.

FAR Ltd is a private limited company that is incorporated in the republic of Unitavia. Despite carrying on business in Exogenia, as a share trader on the Exogenian Stock Exchange, FAR claims not to be resident in Exogenia for the purposes of the Exogenian Income Tax Act 2017, nor for the purposes of various double taxation conventions (DTCs) to which Exogenia is a party.

FAR contends that its place of central management and control is in Unitavia, because that is where its directors, Mr and Mrs Borgas, meet and make decisions about the share transactions in question. Article 4(4) of the Exogenia-Unitavia DTC provides that where a company is a resident of both contracting states, it will be deemed for the purposes of the DTC to be resident only in the state in which its 'place of effective management' is situated.

The Exogenia Commissioner alleges that FAR is controlled by another individual, Mr Gould, who resides in the capital city of Exogenia, and that the directors acted on Mr Gould's instructions. Mr Borgas gave evidence at trial that he, and not Mr Gould, was the ultimate owner of the companies at issue; Mr Gould was merely an adviser. The trial judge rejected the evidence of Mr Borgas and other witnesses called by the taxpayer, and held that FAR was at all material times controlled by Mr Gould. It was therefore resident in Exogenia.

The taxpayer has now appealed to the Supreme Court of Exogenia. In the Supreme Court, the taxpayer has argued that the residence of a company should be determined by the location of its formal, constitutional organs.

You are the President of the Supreme Court of Exogenia. Assuming that the only role of Mr and Mrs Borgas was to implement Mr Gould's decisions (even though they went through the process of minuting resolutions), how would you approach this case, with reference to decided cases? (25)