

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

SAMPLE PAPER

MODULE 3.05 – BANKING OPTION

ADVANCED INTERNATIONAL TAXATION (THEMATIC)

TIME ALLOWED – 3¼ HOURS

This exam paper has **three** parts: **Part A**, **Part B** and **Part C**.

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

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **One** question from **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

Further instructions

- All workings should be made to the nearest month and in Pound Sterling, 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 time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering Parts B and C.
- 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.

For your information this paper is accompanied by:

**Department of Treasury Internal Revenue Service Form: W-8BEN-E / W-8IMY / W-8ECI
(Rev. July 2017)**

OECD Model Tax Convention, 2017: Article 10 and related Commentary

PART A

You are required to answer BOTH questions from this Part.

1. The following notice relates to Chess Depository Interests (CDIs) of Mercury Unicorn (MU), which have been issued in connection to the recent acquisition of the Unicorn Corporation (Unicorn) by Mercury SE (Mercury):

The ten CDIs collectively represent a beneficial interest in one MU Stapled Share, consisting of a Mercury ordinary share and a Unicorn share stapled together. Mercury is incorporated in France and is subject to French Financial Transaction Tax (FFTT). Unicorn is incorporated in Australia and is listed on the Australian Stock Exchange (ASX).

The CDIs commenced trading on the Australian Stock Exchange (ASX) on 14 August 2018.

ASX Participants should note that FFTT is payable on each purchase of a CDI that results in a transfer of ownership. The FFTT reflects the proportion of the purchase that the CDI is represented by the beneficial interest in Mercury shares. The unadjusted FFTT is 0.3%.

The French tax authorities have issued a ruling that the fraction of the value of the Stapled Share to be allocated to the MU share for the purposes of calculating and applying FFTT can be determined on the basis of the respective shareholders' equity of Mercury and Unicorn on 31 December 2017.

The applicable foreign exchange rate is defined as the closing Euro/AUD rate on the currency market on the day before the acquisition of the CDI.

The following transactions in MU were completed in September by Exemplar Australia Ltd (EA), a wholly owned subsidiary of Exemplar Ltd (EL), a UK resident bank. Both EA and EL are classed as Investment Service Providers (ISPs).

<u>ID #</u>	<u>Trade date</u>	<u>Settlement date</u>	<u>Third party</u>	<u>Trade information</u>	<u>EA prop / broker</u>	<u>3rd party buy / sell</u>	<u>No. (000's)</u>	<u>Strike price</u>
1	15 Aug 2018	17 Aug 2018	Australian bank #1	3 rd party cross the futures on market, EA cross the stock on market. 3 rd Party is an ISP	Prop	Sell	500	10.120
2	20 Aug 2018	22 Aug 2018	Major US bank #1	3 rd party buy for their own account, not adhered to AFME protocol, bilateral agreement in place confirming not ISP	Prop	Buy	250	10.210
3	20 Aug 2018	22 Aug 2018	Major US bank #2	Give-up trade to 3 rd party broker (ISP), trade settled in name of end client (not ISP)	Broker	Buy	400	10.175
4	20 Aug 2018	22 Aug 2018	Major US bank #1	3 rd party sell, not adhered to AFME protocol, bilateral agreement in place confirming not ISP	Prop	Sell	185	10.185
5	25 Aug 2018	27 Aug 2018	Exemplar German branch (wholly owned by EL)	German affiliate, adhered to AFME protocol, wholly owned by EL, German affiliate acting as broker to client who is not an ISP	Broker	Buy	250	10.550

Continued

1. Continuation

<u>ID #</u>	<u>Trade date</u>	<u>Settlement date</u>	<u>Third party</u>	<u>Trade information</u>	<u>EA prop / broker</u>	<u>3rd party buy / sell</u>	<u>No. (000's)</u>	<u>Strike price</u>
6	28 Aug 2018	30 Aug 2018	Australian counterparty	Counterparty is an ISP, EA acquiring to fulfil counterparty order for 150,000	Broker	Buy	175	10.850
7	30 Aug 2018	1 Sep 2018	French SE	3 rd Party trading on their own account adhered to AFME protocols	Prop	Buy	300	11.000

The shareholder equity of Mercury and Unicorn is as follows:

<u>Shareholder Equity</u>	<u>Mercury</u>	<u>Unicorn</u>
31 December 2016	€9 billion	A\$18 billion
31 December 2017	€11 billion	A\$19.85 billion
14 August 2017	€13.5 billion	A\$22.5 billion

The applicable €/A\$ exchange rates are as follows:

<u>Date</u>	<u>€</u>	<u>A\$</u>
31 December 2016	1	1.5000
31 December 2017	1	1.5710
14 August 2018	1	1.6025
15 August 2018	1	1.6010
17 August 2018	1	1.6025
20 August 2018	1	1.6125
22 August 2018	1	1.6130
25 August 2018	1	1.6200
27 August 2018	1	1.6250
28 August 2018	1	1.6205
30 August 2018	1	1.6220
1 September 2018	1	1.6300

You are required to:

- 1) **Describe the circumstances in which FTT is applicable and consider its application to the above case, addressing any exemptions which may apply.** (10)
- 2) **Calculate any FTT to which EA is subject, in relation to trades taking place in August 2018, and explain the payment method and reporting required to the French Tax Authority (including reference to the due dates).**

You should explain any assumptions which you make, and provide workings to support the calculation of the return and the reporting due. Your answer should disregard the application of all other taxes. (15)

Total (25)

2. Mega Bank Holdings Ltd (Mega BH) holds a AA credit rating and is the parent company of the Mega group. In order to reduce its financing costs, Mega BH’s management team intends to provide a formal guarantee in relation to tradable corporate bonds that Mega Financial Services Ltd (Mega FS) plans to issue onto the market. Mega FS holds a BB credit rating. Mega Bank Holdings Ltd has been advised that the bonds are likely to be rated as AA.

On 3 July 2018, the Organisation for Economic Co-operation and Development (OECD) released the first public discussion draft on the transfer pricing aspects of financial transactions (the Discussion Draft). The Discussion Draft has been published as a follow up to Actions 8-10 of the Base Erosion and Profit Shifting (BEPS) Project.

- 1) Consider whether Mega FS should pay a guarantee fee to Mega BH. If so, then how should the fee be determined? Your answer should make specific reference to the Discussion Draft.** (10)

A new Mega group subsidiary, Mega Pool, has recently been incorporated in Malta. Mega Pool’s role is to act as a cash pool lender.

The OECD has acknowledged the following, in relation to cash pooling:

“Where independent enterprises seldom undertake transactions of the type entered into by associated enterprises, the arm’s length principle can be difficult to apply because there is little or no direct evidence of what conditions would have been established by independent enterprises.”

- 2) Based on the guidance in BEPS Project Actions 8-10, you are required to advise the Mega group’s chief financial officer on the key tax considerations that the group must consider in relation to this new pooling arrangement.** (11)
- 3) Discuss the findings of the Portuguese Arbitration Tax Court’s 2012 decision on notional cash pooling.** (4)

Total (25)

PART B

You are required to answer ONE question from this Part.

3. A new corporate criminal offence of failure to prevent the facilitation of tax evasion entered into force in the United Kingdom on 30 September 2017.

Upon joining AtoZ Wealth Management Ltd (AtoZ) in January 2018, the company's new tax manager has discovered that no processes to ensure compliance with the new legislation have yet been implemented.

No other AtoZ employees are aware of the new legislation.

You are required to answer the following questions, in relation to the new legislation:

- 1) **Who is defined as an 'associated person'? How is an 'agent' defined?** (3)
- 2) **What is meant by 'dual criminality' in the context of the new legislation?** (4)
- 3) **What is the scope of the new legislation for a UK-headquartered financial institution which has a UK subsidiary and both an overseas permanent establishment (PE) and an overseas subsidiary incorporated under French law? The overseas subsidiary does not conduct business in the UK.** (3)

The tax manager has sought your guidance in ensuring that AtoZ is compliant with the new legislation.

- 4) **Provide an procedural plan for AtoZ using the six reasonable key principles which organisations seeking to prevent the criminal facilitation of tax evasion by associated persons should consider. You should assume that AtoZ does not fall into the lower risk business category.** (10)

4. Bank A, which is resident in Belgium, sold total return swaps on baskets of Swiss listed shares via a broker to other banks residing in different third countries. Dividends would generally fall due on the underlying basket shares during the swap contract period.

The Belgium-Switzerland double taxation agreement (DTA) provides for a withholding rate on dividends of 15%. Switzerland's DTAs with the counterparties' home countries each provide for a 30% non-refundable dividend withholding tax.

Under the terms of each swap, Bank A made a payment to the counterparty on maturity, reflecting the performance of the share price and the entire dividend return.

In order to hedge its financial exposure under the swaps, Bank A purchased an equivalent amount of the underlying Swiss shares in the market via a broker. Upon maturity, the swaps would normally be settled in cash and the Swiss shares sold on the market. As a shareholder of record, Bank A received the dividends net of the applied 35% Swiss withholding tax and subsequently filed for a refund of the Swiss tax withheld, relying on the terms of the Belgium-Switzerland DTA.

You are required to:

- 1) **Consider the concept of 'interdependence' in the 2015 Swiss Federal Supreme Court judgement 2c_377/2012 (the 'Swiss Swaps Case') and the extent to which it is consistent with the OECD Model DTA Commentary on Article 10.** (10)
- 2) **Apply the Supreme Court judgement in the Swiss Swaps Case to the circumstances described above, and determine whether or not Bank A's tax reclaim is viable.** (6)

As a signatory to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the MLI), Switzerland did not make an election in Article 7, thereby adopting the minimum standard of principal purpose test.

- 3) **What are the implications of this decision for Bank A?** (4)

PART C

You are required to answer TWO questions from this Part.

5. **Discuss the Organisation for Economic Co-operation and Development (OECD)'s findings in its 2017 paper "The conditions for establishment of subsidiaries and branches in the provision of banking services by non-resident financial institutions".** (15)
6. The Chancellor of the Exchequer of the United Kingdom explained in 2010 that the UK's new Bank Levy would have two aims:
- to encourage banks to move to less risky funding profiles; and
 - to ensure that banks provide 'a fair contribution in respect of the potential risks they pose to the UK system and the wider economy'.

The Bank Levy was inspired, in part, by a June 2010 IMF report, "A fair and substantial contribution from the financial sector".

You are required to discuss the changes that have been made to the Bank Levy since June 2010. (15)

7. As head of operational tax at a German Bank which is a Qualified Intermediary (QI), with a Japanese branch which is a Qualified Derivatives Dealer (QDD), you have received an email from the Collateral Trading Desk asking for guidance as follows:

Hi,

We are currently negotiating a Securities Lending Agreement with a Canadian bank to carry out stock lending and borrowing as part of our initiative to improve returns on our collateral stock. The other party have requested that we confirm which US withholding certificate we will be quoting (W-8Ben-E, W-8IMY, W-8ECI, etc.).

Under the original plan, as part of its collateral trading strategy the Canadian bank intended to lend its stock of US Treasury Bonds, taking our Japanese Government Bonds as collateral. However, this week the Canadian bank has changed its stance confirming that it will lend US equities.

We will be booking the trades into the Japanese branch of our German parent.

Given the tight timetable, can you urgently advise how we should respond?

Mike

You are required to prepare a reply to Mike, explaining any implications arising from the use of US equities, confirming which withholding certificate should be provided by the German Bank and/or Japanese branch to the Canadian bank, and commenting on the relevant Chapter 3 classification, withholding and any consequent reporting.

You should also advise of any other pertinent factors, and address the implications of the various withholding statements the Canadian Bank is likely to provide to the Japanese branch or German bank.

You should only consider US Chapter 3 Withholding and QI Regulations. (15)

8. Sigma Investments (Sigma) has directly invested in commercial property in Hong Kong over the last ten years, holding less than 5% of its assets in cash with a Hong Kong bank account to cover operating expenses.

Anticipating a downturn in the commercial property market as a result of trade disputes between the United States and China, Sigma has recently liquidated its portfolio, established a limited partnership in the Cayman Islands (SI LP) and transferred 50% of the assets to SI LP. SI LP's banker is a private bank which offers investment advisory services. SI LP has placed 50% of its securities with the United Kingdom branch of the private bank (UK PB) and agreed a discretionary mandate for 10% of the portfolio to be held in custody with UK PB.

Sigma is a Hong Kong resident entity with four beneficial owners, two of whom are tax-resident in Hong Kong, one in the US and one in the UK. Sigma is part-funded with a US\$10 million loan provided by a Hong Kong trust with a Chinese settlor and a non-vested general class of beneficiaries; the corporate trustee of the trust is a Hong Kong entity.

SI LP is a Cayman registered LLC, with a corporate general partner resident in the British Virgin Islands and SI LP as the Sole LP.

You are required to answer the following questions:

- 1) What would Sigma's FATCA or CRS classification be, prior to its change in strategy?**
- 2) How would SI LP be classified under FATCA or CRS? Who, if anyone, would report to the UK Competent Authority under FATCA or CRS, and which Competent Authorities would the UK Competent Authority transmit this information to.**

You should explain any assumptions which you make.

(15)