Chartered Institute of Taxation
Excellence in Taxation

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2015

PAPER 1

PRINCIPLES OF INTERNATIONAL TAXATION

TIME ALLOWED – 3¼ HOURS

- You should answer **FOUR** out of seven questions, including **AT LEAST TWO** from Part I and **AT LEAST ONE** from Part II.
- Each question carries equal marks.
- Start each answer on a new sheet of paper. 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.
- All workings should be made to the nearest month and should use appropriate monetary currency, unless the question requires otherwise.
- Marks are specifically allocated for presentation.

PART I

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

1. “While exchange on request remains the most frequently used method, the emerging tendency is for automatic exchange.”

   (IFA Congress 2013, General Report on Exchange of Information and Cross-border Cooperation between Tax Authorities)

   You are required to discuss the progress made by OECD and the G20 in relation to automatic exchange of information. What are the main benefits and challenges of automatic exchange? (25)

2. “The fact that tax treaties generally have two main purposes – the settling of common problems which arise in the field of international juridical taxation, and the prevention of tax evasion – means that the interpretation of tax treaties can be more complex than the interpretation of other types of international treaties.”

   (Miller & Oats, Principles of International Taxation, 2014)

   You are required to discuss the problems associated with interpretation of tax treaties. Is the current state of affairs satisfactory? (25)

3. **Discuss the allocation of taxing rights in the context of the OECD and UN Model Tax Conventions.** (25)

4. **Critically evaluate the OECD’s 2014 updates to the Model Tax Convention, including the Commentary, highlighting:**

   1) The background to the changes; (15)

   2) The likely impact of the changes; and (5)

   3) Areas which the OECD has yet to include. (5)

   Total (25)

5. **Discuss the extent to which moving away from the separate legal entity approach and the arm’s length principle is compatible with existing international tax rules.** (25)

PART II

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

6.

1) Henna Ltd (Henna), a wholly owned subsidiary of Harlem, Inc. (Harlem), is tax resident in Oland. Harlem is tax resident in Comland.

   Henna required finance from Harlem, for its services project in Oland. This was arranged by Henna, which issued and sold Harlem 300,000 shares in itself at a price of $1 per share.

   The Oland Revenue Commissioner, however, assessed the arm's length price of the shares at $7 each, leading to a shortfall of $1,800,000. The Commissioner also determined that the $300,000 was income in the hands of Henna and that the transfer pricing rules were activated under the Oland-Comland Double Taxation Agreement (DTA), which very closely follows the current version of the OECD Model Tax Convention.

   Furthermore, the Oland Revenue Commissioner found that the $1,800,000 was a deemed loan by Henna to Harlem, on which interest of $90,000 per year was deemed to arise. This interest was also found to be taxable in the hands of Henna.

   You are required to advise Henna of the legitimacy, or otherwise, of the findings of the Oland Revenue Commissioner in light of the Oland-Comland DTA. (12)

2) Two margarine manufacturing companies resident in Factoryland formed a partnership firm, Oil-E Partnership (Oil-E). The two companies are the partners in Oil-E, which was to act as the managing owner of both companies' factories. Oil-E has authority to represent the two partner companies and bind them by its signature, which it does on a regular basis.

   Had Oil-E been established in Factoryland, it would have been fiscally transparent. However, Oil-E was instead established in Dairyland, where such partnerships are treated as taxable entities.

   Oil-E filed tax returns in Dairyland on behalf of the two partner companies. The managing owner was entitled to charge fees for managing the partner companies' businesses, and this was Oil-E's sole source of income.

   Oil-E filed a return claiming nil income taxable in Dairyland after claiming the benefit of the Dairyland-Factoryland DTA, which is identical to the OECD Model Tax Convention.

   You are required to advise Oil-E of its likely position under the Dairyland-Factoryland DTA. (13)

Total (25)

7. For domestic legal purposes, Fred was a tax resident of both Bigland and Littleland during 2014. He was not resident in any other country.

In 2014, Fred received $3 million in employment income earned from outside Bigland and Littleland.

According to domestic law, residents of Littleland are subject to tax in Littleland on such portion of their non-source income as is remitted to Littleland. Fred’s $3m in employment income was not remitted to Littleland.

Bigland requires all of its resident taxpayers to pay tax on their worldwide income.

Article 4 of the relevant Double Taxation Agreement (DTA) between Bigland and Littleland defines the term “resident of a contracting state” for the purposes of the DTA and provides tie-breaker rules for dual residents. By virtue of the tie-breaker rules, Fred is deemed to be resident of Littleland and not Bigland. The Bigland Tax Commissioner nonetheless assesses Fred to income tax for 2014 on his $3 million employment income on the basis that he was a resident of Bigland "for the purposes of the Bigland Income Tax Act".

Article 27 of the Bigland-Littleland DTA provides that:

“Where under any provision of this Agreement any person is relieved from tax in a contracting state on certain income and, under the law in force in the other contracting state, that person is subject to tax in that other state in respect of that income by reference to the amount thereof which is remitted to or received in that other state, the relief from tax to be allowed under this Agreement in the first-mentioned state shall apply only to the amounts so remitted or received.”

There is no issue concerning whether the DTA forms part of the domestic law of Bigland.

You are required to advise Fred on the implications of the Bigland-Littleland DTA. Does the fact that Article 4 deems Fred, through the application of the tie-breaker rule, to be Littleland resident for the purposes of the DTA, override Bigland’s domestic tax law? Does Article 27 enable the Bigland Tax Commissioner to assess Fred to tax as a resident of Bigland on the unremitted income? (25)