THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

December 2024

MODULE 1

PRINCIPLES OF INTERNATIONAL TAXATION

TIME ALLOWED – 3¼ HOURS

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

You need to answer **four** questions in total. You will **not** receive marks for any additional answers.

You must answer:

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

You should therefore answer either three questions in Part A and one question in Part B; or two questions in Part A and two questions in Part B.

Further instructions

- You must use the appropriate monetary currency, unless otherwise stated. Any monetary calculations should be made to the nearest whole unit of currency. Any necessary time apportionments in your calculations should be made to the nearest whole month.
- 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 clarity of presentation of your answers.
- 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 a quarter of your time answering each of your four selected questions.
- There is no separate reading time, so you can start typing your answers as soon as the exam begins. However, we recommend that you set aside some time to thoroughly read each question and plan each of your answers.

PART A

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

1. **You are required to evaluate whether 'residence' remains an effective nexus test for companies in the context of globalisation and the digital economy. Your answer should include a consideration of potential reforms and alternative approaches.** (25)

2. **You are required to consider to what extent it can be said that the approach taken in BEPS Action 4 successfully limits excessive interest deductions, while balancing the need for legitimate financial flexibility in multinational enterprises.** (25)

3. **You are required to critically analyse the nature and purpose of double tax agreements.** (25)

4. **You are required to critically analyse the extent to which the OECD Transfer Pricing Guidelines 2022's classification of multinational enterprise group synergies into 'incidental' and 'deliberate' synergies promotes fair taxation and mitigates tax avoidance.** (25)

5. **You are required to critically evaluate whether linking rules are a more effective solution than tax harmonisation in addressing double non-taxation from hybrid mismatch arrangements.** (25)

PART B

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

6. Danica Ltd (Danica) is a company that is tax resident in Country X and runs a manufacturing business. It also makes various investments using any retained profits that are not used in its manufacturing business or distributed to its shareholders.

On day 1 of tax year 1, Danica acquired 12.5% of the shares in Laurio Ltd (Laurio) for $75 million. Laurio is a company that is tax resident in Country Y. Danica does not make any other investments in Country Y.

Laurio has seven other shareholders, each holding 12.5% of its shares throughout tax year 1. Laurio's accounts show the following asset composition and values on day 1 of tax year 2:

- land situated in Country X, with a value of $100 million;
- land situated in Country Y, with a value of $400 million; and
- interests in entities resident in Country S, that do not hold any land or assets whose value is derived from any land in Country X or any other country, with a value of $100 million.

Danica's management team has become aware that Laurio is considering acquiring shares (which are anticipated to have a market value of $300 million on the date of acquisition) in a number of travel companies resident in countries *other than* Countries X and Y on day 355 of tax year 2. Laurio intends to resell these shares in the first week of tax year 3.

Danica's management team also contemplates selling the company's 12.5% shareholding in Laurio on day 365 of tax year 2 for $150 million. Danica's chief financial officer has noted that the company incurred various costs related to the acquisition of the shareholding in Laurio, and would incur some costs in disposing of the same shareholding, but these costs are likely to be minimal and do not merit further detail or consideration. None of Laurio's other shareholders are considering selling their shares in Laurio.

Country X and Country Y have a double tax agreement (DTA) that is identical to the OECD Model Tax Convention 2017. Both Country X and Country Y use the calendar year as their tax years, and all relevant tax years have 365 days. Danica and Laurio's tax residence status under the DTA is the same as under the domestic laws of Country X and Country Y respectively.

Ignoring the various costs related to the acquisition and disposal of Danica's shareholding in Laurio, you are required to prepare a report that identifies and explains which country, or countries, will have taxing rights on any relevant amounts that may arise where Danica disposes of its shareholding in Laurio on day 365 of tax year two.

Your report should consider:

1) Which country (or countries) will likely have taxing rights, should Laurio enter into the arrangement to acquire shareholdings in the various travel companies; and (12)

2) Which country (or countries) will likely have taxing rights, should Laurio *not* acquire shareholdings in the various travel companies. (13)

Total (25)

7. SmartAdviser Ltd (SA) is a technology company incorporated and tax resident in Country A. Its main business comprises IT advisory services, including the development of tax and accounting software and tailored IT solutions to meet its clients' needs. ConsultingAI Ltd (CAI) is an accounting and tax advisory company incorporated and tax resident in Country B. CAI incorporates artificial intelligence into its services.

SA and CAI have entered into a contract, which was signed and came into force on 1 January of tax year 1, under which SA develops a platform to streamline CAI's international tax compliance reporting systems (the Platform). Upon completion of the development stage for the Platform, CAI is able to offer its clients the option to subscribe to a version of the Platform that is tailored to meet their specific requirements.

The contract outlines two main stages for the development of the Platform, and the relevant terms are as follows:

<u>Stage one (Tax year 1, 1 January – 31 December)</u>

Stage one involves the development of the Platform, where SA is responsible for building the software. The contract specifies that:

- Stage one will end when the beta version of the Platform is released and this must take place by December 31 of tax year 1.

- The beta version is licensed to CAI, but CAI is restricted from distributing, modifying, reverse engineering or disassembling the beta version.

- CAI employees may download the beta version's software to test it or demonstrate it to their clients, with the understanding that the beta version is not yet a final product.

<u>Stage two (Tax year 2, 1 January – 31 December)</u>

During stage two, CAI is to further develop the Platform by tailoring the beta version additions to each of its clients' requirements using its in-house IT department, while SA will provide IT advisory service to support CAI. The contract specifies that:

- Any additions made by CAI during stage two will be built onto the beta version developed in stage one. These additions will constitute separate intangible property owned by CAI and not SA.

- SA's employees will visit CAI's offices in Country B for IT advisory services when necessary, and will provide the following IT advisory services to CAI:

    - planning of work on additions to the beta version;
    - consulting on beta version technical details; and
    - consulting on beta version security.

- CAI reserves the right to deny office access for security or confidentiality reasons. There is no obligation for CAI to provide alternative workspace.

<u>Other contract terms</u>

The contract provides that SA retains ownership of the beta version at all times, with unrestricted rights to license it to third parties. SA is the beneficial owner of income received under the contract.

SA will receive the following payments during each stage:

- Stage one: a lump sum payment for the beta version, paid by CAI to SA on 31 December of tax year 1 and representing payment for SA's development services.

- Stage two: fees to be paid by CAI to SA for the provision of IT advisory services by SA's employees. These fees are calculated on an hourly basis, according to the actual time spent. The fees are to be paid in full for all services provided during tax year 2, by 31 December of tax year 2.

Continued

7. Continuation

Other relevant facts

During tax year 2, SA employees were denied access to CAI’s offices due to security concerns on five separate occasions:

- On two of these occasions, SA’s employees returned to Country A without attending CAI’s offices.
- On the remaining three occasions, CAI rented and provided the SA employees with access to various independent third-party hotdesking facilities in Country B for a combined total of seven days.

SA employees attended CAI 's offices three times, for a total of six days, in tax year 2.

In total, SA employees spent 15 days in Country B in tax year 2.

SA and CAI have entered into a second contract for the licensing of the beta version after the end of stage two, but the details of this second contract are not available.

Country B’s domestic tax law imposes a 15% withholding tax on royalty payments to non-residents, and defines royalties for tax purposes as including payments for partly developed software where ownership is not transferred to the licensee. Country B’s copyright laws protect software as intellectual property.

There is a double tax agreement in place between Country A and Country B, identical to the OECD Model Tax Convention 2017. Both countries use the calendar year as their tax years.

You are required to prepare a report that outlines the taxing rights of Country A and Country B, in relation to any revenues generated by SA under the contract signed on 1 January of tax year 1. (25)