

## IFA TRAVELLING LECTURESHIP 2011

### CASE STUDIES

1. Manufactures Ltd which is resident in Europa has a branch in Australis. The branch pays a charge to head office covering the following:
  - (a) interest at 10% on a "loan" of part of the branch's capital by head office;
  - (b) Manufactures has total external interest costs of \$5,000,000 and it allocates in its financial accounts in accordance with Europa tax law a pro rata share of \$500,000 of this interest to the branch in Australis based on its worldwide operations.
  - (c) a foreign exchange loss on profits of the branch repatriated to head office;
  - (d) \$10 per item as cost of goods sold (the cost of manufacture on an absorption cost basis at head office being \$7.50).
  - (e) fee for accounting services provided by head office (including a markup on cost); and
  - (f) prorated share of other head office expenses (including the salary of Manufactures' CEO).

To what extent is deduction of these expenses required, permitted or prohibited under tax treaties? The local tax administration has disallowed deductions (a) and (c) as not being relevant under Australis law and treaties, disallowed deductions (e) and (f) on the basis that they are included in the cost of manufacture and reduced deduction (d) to \$7.50 and deduction (b) to \$250,000.

2. What has changed under the new article 7 compared to the old article 7?
3. Manufacturers also wishes to know whether it is possible to be taxed on a profit in Australis when overall it makes a loss if the results in Europa and Australis in relation to products sold in Australis are combined.
4. Manufactures pays a patent royalty of \$100,000 to a related company in Ruritania in respect of manufacturing operations carried on by the branch. The royalty is double what would be charged between unrelated parties. Can Manufactures deduct the patent payment in Australis under tax treaties? What if the royalty were half what would be charged between unrelated parties? Why do some countries add the following words to the end of article 7(2) "or with other enterprises with which it deals"?
5. What is a commissionaire arrangement? Can such arrangements be successfully structured for inbound investment into common law countries?
6. If a foreign company carries on its business in a country through an unrelated agent which is not an agent of independent status within the tax treaty meaning and constitutes a permanent establishment of the company, what profits (if any) can be attributable to the permanent establishment? What difference, if any, does it make if the agent is an associate of the foreign company?

7. What are the implications of the new OECD study on transfer pricing in relation to intangibles for PEs?
  
8. Is the deduction rule necessary in the business profits article in tax treaties? Consider a country whose domestic law provides (a) deductions must relate wholly and entirely to income subject to tax; or (b) deductions for payments made outside the country are not deductible.