



TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D5: INTERNATIONAL TAXATION

THURSDAY 17 DECEMBER 2015

TOTAL MARKS – 100; TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.
2. This question paper consists of FOUR (4) questions of Twenty Five (25) marks each. You must attempt all the FOUR (4) questions.
3. Enter your Student number and your National Registration Card number on the front of the answer booklet. Your name must NOT appear anywhere on your answer booklet.
4. Do NOT write in pencil (except for graphs and diagrams).
5. Cell Phones are NOT allowed in the Examination Room.
6. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.
7. All workings must be done in the answer booklet.
8. Present legible and tidy work.
9. Graph paper (if required) is provided at the end of the answer booklet.
10. A Taxation table is provided on pages 2, 3 and 4.

Taxation Table

Income Tax

Standard personal income tax rates

Income band	Taxable amount	Rate
K1 to K36,000	first K36,000	0%
K36,001 to 45,600	next K9,600	25%
K45,601 to K70,800	next K25,200	30%
Over K70,800		35%

Income from farming for individuals

K1 to K36,000	first K36,000	0%
Over K36,000		10%

Gratuity

K1 to K36,000	first K36,000	0%
Over K36,000		25%

Terminal benefits

K1 to K35,000	first K35,000	0%
Over K35,000		10%

Company Income Tax rates

On income from manufacturing and other	35%
On income from farming	10%
On income of Banks and other Financial Institutions	35%
On income from processing of purchased mineral ores, concentrates and other semi-processed minerals	30%
On income from Tolling	30%
On income from mining operations of industrial minerals	30%

(Variable profit tax rate – industrial metals) $y = 30\% + [a - (ab/c)]$

Where:

y = the tax rate to be applied per annum

a = 15%

b = 8%

c = $\frac{\text{Assessable Income} \times 100\%}{\text{Gross sales}}$

Mineral Royalty

Underground Mining operations	8%
Opencast Mining operations	20%
Mining of industrial minerals	6%

Capital Allowances

Implements, plant and machinery and commercial vehicles:

Wear and Tear Allowance –	Plant used normally	25%
	Used in Manufacturing, Farming, Leasing	50%

Non- commercial vehicles		
Wear and Tear Allowance		20%

Industrial Buildings:

Wear and Tear Allowance		5%
Initial Allowance		10%
Investment Allowance		10%
Low Cost Housing	(Cost up to K20,000)	
Wear and Tear Allowance		10%
Initial Allowance		10%

Commercial Buildings

Wear and Tear Allowance		2%
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Farming Allowances

Development Allowance		10%
Farm Works Allowance		100%
Farm Improvement Allowance		100%

Presumptive Taxes

Turnover Tax		3%
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Presumptive tax for transporters

Seating capacity	Tax per annum K	Tax per day K
Less than 12 passengers and taxis	1,200	3.20
From 12 to 17 passengers	2,400	6.60
From 18 to 21 passengers	4,800	13.20
From 22 to 35 passengers	7,200	20.00
From 36 to 49 passengers	9,600	26.00
From 50 to 63 passengers	12,000	32.80
From 64 passengers and over	14,400	39.40

Property Transfer Tax

Rate of Tax on Realised Value of property other than mining rights	10%
Rate of Tax on Realised Value on a transfer or sale of a mining right	10%

Value Added Tax

Registration threshold	K800,000
Standard Value Added Tax Rate (on VAT exclusive turnover)	16%

Customs and Excise

Duty rates on:

1. Motor cars and other motor vehicles (including station wagons) principally designed for the transport of less than ten persons, including the driver:
Customs Duty: 25%

Excise Duty:
Cylinder capacity of 1500 cc and less 20%
Cylinder Capacity of more than 1500 cc 30%
2. Pick-ups and trucks/lorries with gross weight not exceeding 20 tones:
Customs Duty 15%
Excise Duty 10%
3. Buses/coaches for the transport of more than ten persons
Customs Duty: 15%
Excise Duty:
Seating Capacity of 16 persons and less 25%
Seating Capacity of 16 persons and more 0%
4. Trucks/lorries with gross weight exceeding 20 tonnes
Customs Duty: 15%
Excise Duty: 0%

The minimum amount of Customs Duty on Motor Vehicles in categories from 1 up to 3 above is K2,000

ATTEMPT ALL FOUR QUESTIONS

QUESTION ONE

Assume today's date is 14 December 2014.

Your name is Berlin Chomba and you have just returned to Zambia from your attachment as a special business consultant at the Zambian Embassy in the United Kingdom (UK). You were born on 26 August 1964. Your responsibilities as a business consultant at the Zambian Embassy included:

- (1) Representing the country at high level meetings on globalisation.
- (2) Assisting the Zambian tax technical committee to finalise double taxation agreements with various European countries.

You have been in the UK for five (5) years and your emoluments included an annual salary of \$120,000 and an all inclusive allowance of \$4,000 per month. On 1 January 2015, you expect to get a job with Langote Cement Ltd.

Langote Cement Ltd is owned by a big Multinational based in the richest country in Africa. The Multinational has invested over \$ 770 million and the manpower strength is currently nine hundred (900), comprising six hundred (600) female workers and three hundred (300) male workers.

Your income from Langote Cement Ltd and other sources for the year to 31 December, 2015 will consist of the following:

	Notes	K
Salary	1	120,000
Bonus	2	20,000
Funeral grant	3	10,000
Dividend (net)	4	18,000
Rent (gross)	5	20,000
Rent (net)	6	10,000

Notes

- (1) PAYE deducted will be K29,000.
 - (2) This will relate to 2015 but will be paid on 16th January 2016.
 - (3) This will be paid on the demise of your step child.
 - (4) This will be received from his investments in the UK paid net of 10% UK WHT.
 - (5) This will be received net of 5% UK WHT from his house in the UK.
 - (6) This will be received from your tenant in Zambia.
- You can assume that there is no double taxation agreement between Zambia and the UK.

Required:

- (a) Define Double Taxation Relief (DTR). (4 marks)
 - (b) Explain three (3) methods of giving Double Taxation Relief. (6 marks)
 - (c) Calculate the income tax payable by Berlin Chomba for the tax year 2015. (10 marks)
 - (d) Discuss five (5) key benefits of double taxation agreements (DTAs). (5 marks)
- [Total: 25 marks]**

QUESTION TWO

- (a) Some countries have a limited tax base from which the government draws their revenue. As a result, this leads to countries over taxing their residents and organizations. In turn, this leads to residents opting to go to tax havens.

Required:

- (i) Explain what is meant by a **tax haven**. (2 marks)
- (ii) Explain the factors or practices for the identification of tax havens. (4 marks)
- (b) It can be argued that considerations of globalization have resulted in the perceived benefits of tax havens being reduced.

Required:

- (i) Explain what is meant by globalization (2 marks)
- (ii) Explain the benefits of globalization on the Zambian economy. (3 marks)
- (iii) Explain the risks of globalization on the Zambian economy. (4 marks)

(c) Due to globalization, there is an increase in non-resident individuals and businesses.

Required:

Explain how each of the following types of income received by non-residents is normally treated for taxation purposes in the domestic country:

- (i) Domestic employment income. (3 marks)
- (ii) Domestic business profits. (3 marks)
- (iii) Domestic investment income. (2 marks)
- (iv) Foreign income for non-residents. (2 marks)

[Total: 25 marks]

QUESTION THREE

Article 9 of the OECD Model Tax Convention describes how the arm's length principle can be used in transfer pricing to allocate profits among different entities within a multinational enterprise for the purposes of taxation.

Required:

- (a) Explain the meaning and main objectives of the arm's length principle as set out in the OECD Model Tax Convention. (10 marks)
- (b) Describe Five (5) approaches outlined in the OECD Model Tax Convention that may be used to determine an arm's length price for taxation purposes. (5 marks)
- (c) Describe how a Zambian resident subsidiary of a Multinational Foreign Corporation can use each one of the practices outlined below to reduce its liability to Zambian income tax and hence the tax liability of the group as a whole and discuss how the arm's length principle is applied to prevent such practices:
 - (i) Obtaining excessive debt finance from foreign members of the group.
 - (ii) Making low interest loans to foreign members of the group.
 - (iii) Transfer pricing policies for transfers of goods within the group. (10 marks)

[Total: 25 marks]

QUESTION FOUR

Central Bank staff from nine COMESA Member states including Zambia have undergone training to enable them handle financial market volatility which poses risks on economic growth. The objectives of the training were:

- (1) To develop capacity of Central Bank staffs from Member Countries and enhance the implementation of the COMESA Framework for Assessing Financial Stability and Knowledge sharing.
- (2) To provide a forum for networking between member states on issues related with financial stability.

The training equipped the participants with appropriate analytical skills and rigour to be able to adequately measure and forecast volatility in prices of financial market assets.

COMESA has planned another training programme for Tax Authorities in effective customs services, General Agreement on Tariffs and Trade (GATT) and World Trade Organisation (WTO) regulations.

Required:

- (a) Explain four (4) functions of the Customs services division of the Zambia Revenue Authority. (4 marks)
- (b) Discuss the GATT rules and limitation on border tax adjustment. (9 marks)
- (c) Explain the international origin principle or basis for indirect taxation. (4 marks)
- (d) Discuss the WTO dispute resolution rules and taxes. (8 marks)

[Total:25 marks]

END OF PAPER

D5: INTERNATIONAL TAXATION

SUGGESTED SOLUTION

DECEMBER 2015 EXAMINATIONS

SOLUTION ONE

(a) Double Taxation Relief (DTR) is a relief that is given to eliminate the effects of double taxation in a case where income being charged to tax in a country has already been charged to tax in another country. If DTR was not available, taxable persons would bear too much tax on the same income as that income would then be subjected to tax in several countries.

(b) Three methods of giving DTR are treaty relief, unilateral credit relief and unilateral expense relief.

Treaty relief is applicable where there is a double taxation convention between two countries. The treaty would provide for how the relief would be granted on inter country income. The methods under which the relief would be available may be by way of exemption, where income subjected to tax in one contracting state would be exempt from tax in the other contracting state or by way of credit, where tax already paid on the same income in one contracting state is given as a credit against tax payable on the same income in the other contracting state and so on.

Unilateral credit relief applies where there is no double taxation convention. In such a case, DTR may be granted unilaterally in the country where the income is received by crediting against the tax charged in that country, the amount of foreign tax paid, if lower than the local tax payable.

Unilateral expense relief is also available where there is no double taxation convention. In this case, DTR is given unilaterally in the country where the income is received by treating the foreign tax paid as an allowable expense.

(c) Berlin Chomba

Personal Income Tax Computation - 2015

	K
Salary	120,000
Bonus	20,000
Foreign dividend $18,000 \times 100/90$	<u>20,000</u>
Total income	160,000
NAPSA	<u>(3,060)</u>
Taxable income	<u>156,940</u>
Income Tax	
156,940	
<u>(36,000)</u> x 0%	0
120,940	
<u>(9,600)</u> x 25%	2,400
111,340	
<u>(25,200)</u> x 30%	7,560
86,140	

<u>(86,140) x 35%</u>	<u>30,149</u>
<u>0</u>	
Income tax liability	40,109
Less Double taxation relief (DTR) (W 1)	<u>(2,000)</u>
	38,109
Less tax already paid	
PAYE	<u>(29,000)</u>
Income tax payable	<u>9,109</u>

WORKING

1. Double taxation relief (DTR)

Lower of:

a) Foreign tax on foreign income

$$\text{Dividend } 20,000 * 10\% = \text{K } 2,000$$

b) Zambian tax charge on foreign income

$$\frac{20,000}{156,940} * 40,109 = \text{K } 5,111.38$$

DTR is therefore K 2,000.

(d) The key advantages of double taxation agreements (DTAs) include:

- (i) Protect against the risk of double taxation where the same income is taxed in two states. This could present a "huge" burden on the taxpayers and effectively work against the promotion of globalisation and its resulting benefits.
- (ii) Provide certainty of treatment for cross – border trade and investment. Certainty is one of the good qualities of a good tax system. Taxes should be certain. If tax rules are are complex, they can be subverted and evaded.
- (iii) Prevent excessive foreign taxation and other forms of discrimination against business interests abroad. This could have an adverse impact on economic performance of the respective countries.
- (iv) Protect the government's taxing rights and protect against attempts to avoid or evade tax. Aggressive tax avoidance and/or tax evasion could result in significant reduction in tax revenues. This could result in reduced service delivery, in key sectors of the economy, by the government.
- (v) They also contain provisions for the exchange of information between national taxation authorities. This could boost tax revenue and impact positively on the respective economies.

SOLUTION TWO

- (a) (i) A tax haven is a country with lenient tax rules or relatively low tax rate which are often designed to attract foreign investments.
- ii) Tax havens are sometimes done in earnest for the benefit of the local residents. However some countries have introduced harmful tax practices that encourage non-compliance with tax laws of other countries. Four factors or practices for the identification of tax haven are:-
1. No or only nominal tax on the relevant income or usually capital.
 2. Lack of effective exchange of information by strict secrecy rule and other protections against scrutiny by tax authorities thereby preventing the effective exchange of information on taxpayers benefiting from low tax jurisdiction e.g. Swiss bank accounts in the past.
 3. Lack of transparency – e.g. the details of the regime and/or its application is not apparent, or there is inadequate regulatory supervision or financial disclosure.
 4. No substantial activities in country where the jurisdiction facilitates the establishment of foreign owned entities without the need for a local substantive presence. This is what makes it doubtful how small islands can host billions of dollars in foreign direct investment if they apparently do not have the necessary resources to yield production.
- (b) (i) Globalization in simple terms is a situation where the world is considered as one big village in terms of economic practices. Most economists agree that globalization provides a net benefit to individual economies around the world by making markets more efficient increasing completion, limiting military conflicts and spreading wealth more equally round the world. However the general public view tends to assume that the costs associated with globalization outweigh the benefits especially in the short – term which has caused problems espoused by the protectionism theory.

(ii) Benefits of Globalization on the Zambian Economy

- (1) Foreign Direct Investments: tends to increase at much greater rate than the growth in world trade, helping boost technology transfer, industrial restructuring, and the growth of global companies.
- (2) Technological innovation; increased competition from globalization helps stimulate new technological development, particularly with the growth in FDI, which helps improve economic output processes more efficient.
- (3) Economies of scale: Globalization has enabled large companies to realize economies of scale that reduce costs and prices, which in turn support further economic growth although this can hurt many small businesses attempting to compete domestically.

(iii) Risks of Globalization on the Zambian Economy

- (1) Interdependence: Globalization leads to interdependence between nations, which could cause regional or global instabilities, if local economic fluctuations end up impacting a large number of countries relying on them.
- (2) National sovereignty: some see the rise of nation states, multinational or global firms and other international organizations as a threat to sovereignty. Ultimately, this could cause some leaders to become nationalistic or xenophobic.
- (3) Equity Distribution: The benefits of globalization can be unfairly skewed towards rich nations or individuals, creating greater inequalities and leading to potential conflict both nationally and internationally as a result.
- (4) Tariffs and other forms of protectionism: The 2008 economic crisis led many politicians to question the merits of globalization. Since then, global capital flow fell from \$11 trillion in 2007 to a third of that figure in 2012. While some of that may be, cyclical in nature, many countries implemented tariffs and other forms of protectionism designed to contain risk in their financial systems and make crises less damaging, although this was at a cost of forgoing the benefits we have so far seen.

- (c) (i) Domestic employment income is usually subject to the normal withholding tax. There are special tax collection problem where the employer is a non-resident, but tax treaties usually will profit the employee from taxation by the country where the work is performed in this event through the 183-day rule.

Some transition countries find it difficult to cope with withholding tax on wages of expatriates because their wages are paid into bank accounts in foreign countries. However, tax treaties make penalties severe for such practices.

- (ii) The problem of domestic business profits of non-residents is the determination or description of profits as either:-
- The net assessment basis of the income attributable to a permanent establishment in a country.
 - Income taken out as profits as dividends interest, royalties, management fees, consultancy etc.

Countries normally experience problems in the treatment of allowable deductions from the gross income of non-residents, before being taxed. For dividends, royalties etc. a withholding tax basis is normally applied.

- (iii) For domestic investment income of non-residents e.g. dividends, interest, royalties etc. paid to non-residents usually provides for flat-rate final withholding tax on the gross amount. The W.H.T rate is normally reduced to 10 - 20 percent by treaties as high W.H.T rate wipes out the entire profit.
- (iv) For foreign income of non-residents on a short stay is not normally taxable. For a more extended stay of, say between six months or two years, but where the

person's family and permanent home is behind in the home country, the person will generally become a resident but the tax treatment tends to be problematic and will depend on whether the individual's country has a treaty or no treaty.

SOLUTION THREE

(a) Meaning of the Arm's length principle

The arm's length principle states that transactions between connected parties should be treated for tax purposes by reference to the amount of profit that would have arisen if the same transactions had been executed by unconnected parties. The terms which would be expected to be seen between independents are referred to as being at 'arm's length'. The arm's length principle is applied to a controlled transaction by replacing hypothetically the actual terms or price under which a transaction was done with arm's length terms and for tax purposes, recalculating the profits accordingly.

Main objectives of the arms' length principle

The main objectives of the arms' length principle include the following:

- (1) To achieve a fair division of taxing profits and to address international double taxation as the trading arrangements and pricing policies under which multinational groups operate can result in terms considerably different from those which would have been seen between independents engaged in the same or similar transactions for a number of reasons.
- (2) To make the correct application of the separate entity approach possible and therefore secure the appropriate tax base in each jurisdiction involved;
- (3) To eliminate effects and distortions of the associated enterprises' special commercial and financial conditions on the levels of profits;
- (4) To provide broad parity of tax treatment for MNEs and independent enterprises, that is to provide a tax treatment which is neutral towards the type of entity;
- (5) To put associated enterprises and independent enterprises on an equal footing for tax purposes;
- (6) To serve the general principles of equality and neutrality in tax law;
- (7) To avoid a distortion of the relative competitive positions between associated and independent enterprises;
- (8) To promote international trade and investment by removing tax considerations from economic decisions.

(b) **Approaches used to determine an arm's length price**

The OECD Guidelines consider five methods for reaching the arm's length price which are divided into traditional transactional methods and transactional profit methods. The traditional transaction methods include, the comparable uncontrolled price, the resale minus and the cost plus methods whilst the transactional profit methods are the profit split and transactional net margin method.

Comparable Uncontrolled Price method

This method simply compares the price in the controlled transaction with the price in a comparable uncontrolled transaction. If there is a difference, then the commercial and financial relationship between the associated parties may mean the price is not at arm's length. The price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction. However, identifying good, reliable comparable uncontrolled transactions can sometimes be difficult in practice

Resale minus

The resale price method begins with the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. This price known as the resale price is then reduced by an appropriate gross margin on this price (the "resale price margin") representing the amount out of which the reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit.

What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. customs duties), as an arm's length price for the original transfer of property between the associated enterprises. This method is probably most useful where it is applied to marketing operations and is most useful where a company purchases goods for distribution from a connected party.

Cost plus

The starting point of this method is be the costs incurred by the supplier of the goods or services. A 'plus' percentage should be added to this to give the supplier a profit appropriate to the functions carried out and the market conditions. The profit element should be calculated by reference to the profit the supplier earns in comparable uncontrolled transactions (an "internal comparable"). Failing this possibility (because the supplier does not enter into comparable uncontrolled transactions), the mark up that would have been earned in comparable transactions by an independent enterprise (an "external comparable") can serve as a guide.

The cost plus method is most useful where semi-finished goods are transferred between related parties (e.g. a manufacturing company selling to a distribution affiliate), where

joint facility agreements have been concluded, or where the controlled transaction is the provision of services.

Profit split method

The profit split method attempts to eliminate the effect of a control relationship on profits accruing to each connected party by determining the division of profits that independent enterprises would have expected to realise from engaging in the tested transactions using either a contribution analysis profit split or a residual profit split.

This method is recommended for very complex trading relationships involving highly integrated operations, where it is sometimes genuinely difficult to evaluate those transactions on a separate basis. The profit split method is therefore a 'two-sided' transfer pricing method.

Transactional Net Margin method

This method begins by comparing the net margin which the tested party makes from a controlled transaction with the net margin it makes from an uncontrolled one (an "internal comparable"). Where this proves impossible then the net margin which would have been made by an independent enterprise in a comparable transaction (an "external comparable") may serve as a guide.

They concentrate on finding the arm's length net profit margin as opposed to the gross profit margin sought by the 'traditional' methods of CUP, resale minus and cost plus.

(1 mark for brief explanation of each method up to maximum of 5 marks)

(c) (i) **Excessive debt finance from foreign members of the group**

Multinational companies are motivated to finance their foreign subsidiaries through loans rather than share capital because in many jurisdictions including Zambia, interest paid on loan finance is allowable, whereas, dividends paid to equity providers are not. As a result, when a Zambian resident subsidiary of a foreign multinational is heavily financed by debt obtained from foreign members of the group, its taxable profit will be substantially reduced by interest payments made on such loans.

To prevent huge reductions of taxable profit by way of interest deductions, thin capitalisation rules are put in place. These rules limit the amount of interest that would be allowed as a deduction when computing taxable business profits. This is done by not allowing as an expense, the amount of interest paid when the company's debt equity ratio exceeds a certain limit.

In Zambia, some mining companies are subsidiaries of foreign companies. These foreign companies may finance the subsidiaries through high level of debt. Interest on such loans will only be allowable as an expense when the debt equity ratio does not exceed the ratio 3:1. When the amount of debt obtained results in

this ratio being exceeded, then interest on the excess debt is not an allowable deduction.

(ii) **Cheap loans to foreign members of the group**

Making loans at an interest rate which is lower than the commercial rate has the effect of reducing the taxable profits for the company receiving the interest. This is because the taxable profits will be lower than they should have been if the higher interest or commercial rate had been used.

A Zambian resident subsidiary can therefore substantially reduce its tax liabilities by making loans to foreign members of the group and charging a reduced rate of interest on such loans.

When a Zambian resident company makes a loan to a foreign related company, it must charge interest on such a loan at a commercial rate. When the interest rate charged on such a loan is less than the commercial rate, the company receiving the interest is deemed to have received the interest at the commercial rate.

(iii) **Transfer pricing policies**

Multinational companies may produce goods in one country which are then transferred for sale to other countries. Multinational companies may manipulate the transfer price so that profits arise in a country where the rates of taxation are lower so that the overall tax position of the group is minimised.

A Zambian resident subsidiary may therefore transfer or sale goods to a foreign member of the group at a price which is lower than the market value of those goods therefore reducing the taxable profit of the Zambian resident company. This will normally be in a situation where the tax rates that apply in the country in which the foreign company operates are lower than those applying to the Zambian resident company.

Alternatively, the Zambian resident may purchase goods from foreign members of the group at a price that is higher than the market price so as to increase cost of sales and thus reduce taxable profit.

Anti-avoidance legislation attempts to prevent a company from transferring goods out of the country at a price which is lower than the market price of those goods. As such, when a Zambian company is required to transfer goods produced in Zambia to a company that is resident abroad, then the transfer price should be equal to at least, the market value of the goods. When the transfer price is lower than the actual market value of the goods being transferred, then the profit element must be added when computing taxable profits.

SOLUTION FOUR

a) Four (4) functions of the Customs Services division of ZRA are:

- i) Collection and management of Customs and Excise duties and other duties, licensing and control of warehouses and premises for the manufacturing of certain goods. This is one of the ways used by the Authority to raise funds to finance government expenditure. Some of the duties are used as a means of protecting local industries.
- ii) Regulation and control of imports and exports. Some goods could be harmful to human and animal life, including the environment e.g the effect of drugs on human beings. Customs officers have to ensure that all imports and exports are properly scrutinised and comply with laws and regulations.
- iii) Facilitation of trade, travel and movement of goods. Unnecessary delays at the borders could "hurt" economic activity in the country. The operations must be efficient. The recent upgrade to ASYCUDA World is a big step in the right direction. In addition, the "one stop" border concept has significantly improved efficiency.
- iv) Providing statistical data to the Government on imports and exports. This is an important function in the management of the economy. It enables government and other stakeholders make informed decisions.

b) The General Agreement on Tariffs and Trade (GATT) as amended by the Uruguay Round Amendments, which created the World Trade Organisation (WTO), contains rules on Border Tax Adjustment (BTAs). No single section of this agreement deals exclusively with BTAs; however, rules addressing BTAs can be found throughout, namely in Articles II, III and XVI.

According to the OECD Working Party, BTAs are any fiscal measures that put into effect the destination principle in whole or in part. In other words, BTAs relieve exported products of some or all of the tax the exporting country charged on similar domestic products in the home market and enables the importing country to charge some or all of the tax on imported products that it charges on similar domestic products. The term "border tax adjustment" is somewhat confusing because it suggests that a fiscal measure is applied at the border, which is not always the case. Although in many cases imports are taxed on entry, certain countries apply a tax to imports after the goods have crossed the border and have been sold to other merchants or consumers. Moreover, the OECD has noted that certain tax systems do not tax exports at all and make no adjustment at the border. Considering these varying tax systems, the OECD Working Party has recommended the replacement of the term "border tax adjustment" with "tax adjustment applied to goods entering into international trade."

The OECD's careful treatment of BTAs illustrates that they are not a novel concept to international trade. However, BTAs have only recently been considered as an innovative policy option for addressing the challenges of climate change. The concept of climate change BTAs is as follows: carbon – taxing countries would levy import fees on goods that non – carbon taxing countries manufacture. The motivating factor for these measures is at least, in theory, internalise the real costs of producing goods and services with respect to international climate change regulation, thereby leveling the playing field between producers of like products from different countries.

A BTA would tax imported goods the equivalent of what the producers would have had to pay to produce them in the home market they are entering. Under this system, domestic producers in countries with carbon taxes will not face costly climate change measures that foreign producers do not face in their home countries. An alternative approach would be to impose taxes on imported goods that are equivalent to the enforcement of emissions allowance trading. Therefore, in order to import products from a nation that does not comply with the carbon taxes applied in the importing country, an importer of goods would be required to purchase emission rights in his country, compensating for the difference.

- c) This espouses that internationally traded commodities are taxed at the rates prevailing in the country where goods are produced, and this is the country receiving the tax revenue. Under the origin principle, exports are taxed and imports are exempted, so that in equilibrium, the home (foreign) country's consumer must be indifferent between paying for domestically produced goods and for those imported.

Alternatively, the destination principle or basis espouses that internationally traded commodities are taxed at the rates prevailing in the country where final consumption takes place, this being the country which obtains the tax revenue.

- d) Both international trade and environmental law have discussed the legality of BTA measures and WTO law. However, up to now, neither BTA's nor climate change policies have been challenged under the WTO dispute settlement system. According to the Kyoto protocol Article 2.3 provides that parties included in Annex 1 "shall strive to implement policies and measures under this article in such a way as to minimise adverse effects, including the adverse effects of climate, effects on international trade, and social, environment and economic impact on other parties, especially developing country parties."

However, it is not clear that Kyoto protocol permissive rules on policies and measures are in conflict with WTO law, either directly or indirectly and some scholars believe that properly designed BTA's would meet WTO rules, yet other disagree.

BTA's are exclusively allowed by the GATT as long as the tax imposed on imported goods is no greater than the tax established for similar domestic products. It has been noted that GATT does not impose any requirement that nations adopt a tax base that can be administered without double taxation, in fact or principle. For example, countries can impose the BTAs on imports without any corresponding rebate for exports.

However, it is still uncertain whether BTAs can be used for taxable inputs that are not physically incorporated into the final traded product. For instance, it is not clear if an import tax could vary based on the amount of carbon dioxide emitted during the goods production - WTO rules would have to be interpreted in a way that considers products not to be 'like' each other based on their carbon foot prints.

END OF SOLUTIONS