



IBEROAMERICAN TAX MOOT COURT 2013
Case Competition

Kabouter Inc is the head of a business group dedicated to the mining and energy sector, incorporated in year 1990 in Bentalia. The group has decided to begin its expansion in the Austral continent. For such purpose, *Coalis* was incorporated in Flamante in year 2008, a country that has an excellent network of tax treaties with an important number of countries of the Austral continent, in contrast to Bentalia, a country that has very few tax conventions in the region. Bentalia has an exemption regime for dividends distributed by non-resident companies.

Flamante has a domestic holding regime that grants exemption for foreign dividends and capital gains in addition to an exemption for distributed dividends. The Tax Administration of Flamante has conditioned the benefit of the mentioned regime to the holding having an adequate organization of human and material resources, being its position divergent as of the date in cases that are before the courts related to when the condition is complied with or not.

Coalis does not have any relevant asset located in Flamante. Its Board of Directors was appointed by *Kabouter*, whose members are employees of the later; the Board of Directors meets and keeps record of its decisions in Flamante in general, even though this is done through web based technology very often since their members are in different countries. *Coalis* has an employee who is its CEO, residing in Flamante and who merely performs the instructions given by the Board of Directors; he has an office rented in a lawyer office. The main purpose of *Coalis* is to make investments and perform financial activities. *Coalis* generally distributes its profit -coming from dividends distributed by subsidiaries- in a term not exceeding two months, sometimes being few weeks. Even if its tax returns have been submitted, *Coalis* has not paid any Corporate tax to Flamante since its incorporation.

In January 2009, *Coalis* incorporated a subsidiary called *Strato* in the country of Tropicón, which performs coal extraction activities. *Coalis* owns 100% of *Strato*'s shares. On February 1st, 2010, *Strato* distributed dividends by \$ 100 M for the activities developed during year 2009. Even if the tax on dividends in Tropicón according to its internal regulations rises to 25, by virtue of the DTC between Flamante and Tropicón (2010 OECD model except for dividends) taxation of



dividends is attributed exclusively to the residence state. According to this, no tax was withheld by *Strato* on the distributed dividends.

On the other hand, *Kabouter* has decided that its investments in Marinalia -another austral country with strong investments of Bentalian origin and where important reserves of Molybdenum have been discovered- will be made through *Strato*. For such purposes, *Strato* incorporated in July 2010 a 100%-owned subsidiary in Marinalia called *Bicluster*. The company has a Board of Directors and a very high level management team according to their business needs. Nevertheless, it is important to highlight that the Board of Directors is made up by all the employees designated by *Strato*, who frequently meet in Tropicon and communicate their respective decisions to the team of directors in *Bicluster*.

After a verification procedure conducted to *Strato*, in year 2013 the Tax Administration of Tropicon raises an action against this company under its capacity of withholding agent for the failure to withhold on the dividends paid to *Coalis*. The alleged 25 % withholding according to the domestic rate is based upon a rule of Tropicon according to which a DTC must prevent double taxation but in no case should lead to the non-taxation of an item of income. In addition, the Tax Administration has pointed out that *Coalis* cannot be considered beneficial owner of the dividend and that there is an abusive behaviour on its part.

In 2013, the Tax Administration of Tropicon has also established that *Bicluster* is a company residing in Tropicon, since its place of effective management is located in such State. This has been done through a financial settlement document issued to *Bicluster* imposing a 25% tax on revenues \$100M, which were received from the activities performed in Marinalia by *Bicluster*. There is a 2010 OCDE DTC between Tropicon and Marinalia.

The Tax Administration decided to treat *Bicluster* as a resident, instead of applying its new domestic CFC rules, as far as these rules have been seriously contested in the country due to serious constitutional concerns. In addition, there is a strong lobby on Marinalia's part considering that those CFC regulations may be contrary to DTCs, particularly those that follow the OECD model.

Strato and *Bicluster* have protested the assessments issued by the Tax Administration, but they have been maintained by the tax administration and by the Tax Tribunal. According to the Tropicon "Group litigation act" – which enables a unique proceeding before the highest administrative court of Tropicon to deal with



related tax assessments issued to subsidiaries of the same group- *Strato* and *Bicluster* have appealed the decisions of the Tax Tribunal. Both companies take the position that the assessments are unlawful because they are a violation 1) Of the DTCs between Tropicon and Flamante and Tropicon and Marinalia. 2) Additionally in case the CFC rules of Tropicon become applicable they consider them to be in breach of the DTC between Tropicon and Marinalia and the Constitution of Tropicon that recognizes the ability to pay principle and, according to the tax payers, the “realization principle”. In the procedure before the highest administrative court of Tropicon, the court will take into consideration all relevant arguments of national law and international treaty law.