



## IBEROAMERICAN TAX MOOT COURT 2014

### CASE COMPETITION

*OPREMA SOFTWARE* is a company domiciled in PORIGI, and has positioned itself as a leading company after developing the software known as BUVA, which has revolutionized the telecommunications market. Furthermore, *OPREMA SOFTWARE* provides support and maintenance services for the BUVA software.

The local laws of PORIGI, an OECD member country, only considers as tax residents those legal persons incorporated in the country pursuant to its commercial laws; however, in all Double Taxation Agreements signed, PORIGI follows the OECD Model Tax Convention (hereinafter MOCDE) with no reserve in this regard. Furthermore, a Patent Box exists in PORIGI granting an exemption for the exploitation in foreign countries of intangibles developed in PORIGI, and for the services related to them.

After evaluating the global market, *OPREMA SOFTWARE* decides to expand its operations to the RUSCO continent by incorporating the company ATX COMPANY in early 2012 in the country of BORDONIA.

BORDONIA only considers companies as tax residents when they have their effective place of management in its territory. It is a member country of the OECD and follows the MOCDE in all signed Double Taxation Agreements; however, it has set a reserve to article 12 of the MOCDE indicating that it reserves the right to consider the transfer of intangibles as royalties in cases where there is no full transfer of ownership.

BORDONIA and PORIGI signed a Double Taxation Agreement in 2011 which follows the MOCDE, establishing a withholding tax of maximum 10% for royalties, and, additionally, Article 5 of the Double Taxation Treaty includes a provision which states that:

*“The provision of services by a company, through employees or other individuals appointed by the company for such purpose, shall also be construed as a Permanent Establishment in the event that such activities continue in a Contracting State during a period or periods which in the aggregate exceed 183 days, within any twelve month period.”*

For the incorporation of *ATX COMPANY*, *OPREMA SOFTWARE* contributed the ownership of the BUVA software. However, the ownership of said software is limited

in time (5 years upon the date in which the company was incorporated) and also by a clearly delimited geographical zone (the Rusco Continent) with respect to exploitation possibilities. Ninety percent (90%) of the revenues earned by *ATX Company* come from its activities in the other countries of the Rusco Continent and the remaining come from its activities in BORDONIA.

*ATX COMPANY* is a company with a large number of employees in Bordonia and with numerous commercial establishments and clients in the country; the members of the Board of Directors of *ATX COMPANY* meet in PORIGI and take decisions in said country, where they leave proper minutes of the meetings and the decisions taken. However, the members of the Board travel 4 times a year to Bordonia to formalize decisions previously taken in PORIGI; the decisions of the Board are informed to the high executives of *ATX COMPANY* who are ultimately the ones who implement the decisions taken in their respective business areas.

*ATX Company* had a resounding success in the Rusco Continent, and thus, was able to close numerous deals with companies located on the other countries of said continent. A case worth highlighting are the contracts that *ATX COMPANY* executed with companies located in the country of **TRAVIA**, with which, depending on the profits agreed for each case, either allows the use of the software in exchange for an agreed consideration or, in other cases, sells the BUVA software in exchange for a percentage of the profits gained by the buying company during a period of 10 years upon the date of the sale.

There is a Double Taxation Treaty between BORDONIA and TRAVIA effective since 2011, which follows the MOCDE, and which establishes a withholding tax of maximum 5% for royalties. In repeated occasions, the Tax Administration of Travia has clarified that the amount paid for the sale of intangibles, when considered to be linked to the profits or income derived from the exploitation of such intangible, shall be construed as a royalty. In this sense, all payments received by *ATX COMPANY* derived from TRAVIA have been subject to a 5% withholding tax.

Moreover, given the expansion of its business, *OPREMA SOFTWARE* decided to start providing support and maintenance services of the BUVA software on May 2012; for such purpose, it appointed a group of highly qualified engineers in Bordonia, in order to provide the aforementioned services to *ATX COMPANY*'s clients in the Rusco Continent.

In the year 2014, after an auditing process, *OPREMA SOFTWARE* and *ATX COMPANY*, acting jointly, filed a lawsuit against the Tax Administration of Bordonia.

The following issues are debated in the lawsuit:

1. Regarding the income derived from the contribution of the software by *Oprema Software*, and considering that this company did not pay taxes in Bordia, the Tax Administration considers that the shares received as consideration for the contribution of the software must be understood as the payment of a royalty.

Furthermore, the Tax Administration has also questioned the value for which the software was contributed as the base value of depreciation, considering that during years 2012 and 2013, the expense for this concept has been annulling the profit of *ATX Company*, and it has even derived in tax losses.

2. *ATX Company* has paid taxes in BORDONIA as a non-resident by justly considering that its effective place of management are located in another country, and therefore paying taxes only for the income of Bordonian source. However, the Tax Administration of Bordia does not share this view and has determined that *ATX COMPANY* must be considered as a tax resident in Bordia, since it complies with the residence rule set forth by its local laws; therefore, the Tax Administration considers that *ATX COMPANY* must pay taxes for all its income and not only for its national source income.

In addition, the Tax Administration intends to apply the GAAR established by its local laws, arguing that the entire scheme constitutes an abuse considering that as a result of the scheme, no taxes will be paid over the gained income. Such provision states that:

*“The use or implementation of any deceptive scheme, with the sole purpose of modifying or distorting the reality of the transaction, operation, among others, in order to evade or reduce the tax obligation shall be considered an abuse.”*

3. Within the auditing process with the tax authority of Bordia, *ATX COMPANY* has argued, regarding the residence issue, that if it must pay taxes for its worldwide source income, then the taxes paid in Travia should be credited in its favor. This argument has been partially rejected by the Tax Authority of Bordia which states that the taxes withheld in Travia in connection with the income derived from the sale of the software were taxes paid outside the



scope of the Double Taxation Treaty, and are not subject to taxation in the state of the source since they are not construed as Royalties.

4. On a separate matter, the Tax Administration alleges that a Permanent Establishment of *OPREMA SOFTWARE* was established in Bordia and therefore, the company shall have paid taxes for the totality of the income attributable to said Permanent Establishment. According to Bordonian local law, it is understood that *OPREMA SOFTWARE* will, for all effects, be deemed to be represented by its subsidiary, the company *ATX COMPANY*.