



IBEROAMERICAN TAX MOOT COURT 2018 Case Competition

I. ENTITIES AND INDIVIDUALS

- A. CORPORATION OF THE CIRCUS OF THE KARAMAZOV BROTHERS INC. (SCK) fiscal resident in Mapleland.
- B. PRODUCTION AND ENTERTAINMENT LTD. (P&E), tax resident in Tequiland.
- C. Mr. Iván Karamazov, juggler star of the Circus, fiscal resident in Mapleland.

II. ISSUES

- A. From the beginning of the 20th century, the Karamazov family has engaged in artistic activities, following the tradition of the Bolshoi Ballet. In 1950 they formed the Corporation of the Circus of the Karamazov Brothers Inc. (hereinafter SCK), to which they granted the use and exploitation of the economic rights derived from the show.

Ever since, the Circus of the Karamazov Brothers has been one of the most recognized artistic shows worldwide. Although the Circus has a permanent location at the Alexander's Palace Hotel in Las Vetas, Helada (a city located in a country named Hamburland), it also reaches the public through the tours that take place in the main cities of the world.

For international performances, SCK grants the promotion, development and disclosure rights to companies that are resident in the countries where the presentations will take place. By virtue of these ***promoting agreements***, the contracting company pays SCK \$50 million sombrepesos, as a consideration for the exercise of said rights. Additionally, the company that acquires promotion, development and disclosure rights carries out the necessary activities for the promotion and diffusion of the two (2) shows that the Circus will hold in the corresponding country.

The tours take place twice a year, one April and one November, and last one week each. On Monday, the artists arrive in the city where the shows will be held. Tuesday through Thursday are left for rehearsal and stage tests, while Friday and

Saturday are performance days (9:00 a.m. to 12:00 p.m.). Lastly, the artists travel to their next location on Sunday.

In 2012, SCK decided to take the show to Kanguron Continent, specifically to a country named Tequiland. Thus, on May 31st, SCK entered into a promotion contract with Production and Entertainment Ltd. (hereinafter P&E).

Under the agreement, P&E obtained the promotion, development and disclosure rights of the show from 2015 to 2017, in exchange for two half-annual sums of \$25 million sombrepesos each, which had to be paid in April and November. On the other part, SCK reserved the right to intervene in the decisions made by P&E in relation to the performances.

The presentations took place on the agreed dates at the U4 Arena, which was also available for the accommodation of the SCK crew. Furthermore, from 2015 to 2017, a warehouse was left at the disposal of SCK for the storage of lighting and sound equipment that, due to its size, could not travel with the artists.

Each year (2015, 2016 and 2017) the box office and the broadcasting of the show produced earnings for \$120 million sombrepesos.

- B. However, in 2016, P&E only paid one of the installments provided in the contract. Therefore, P&E had a debt with SCK for \$25 million sombrepesos.

On November 30th, 2016, P&E and SCK reached a new commercial agreement in relation to the aforementioned debt, in light of which P&E issued redeemable preferred shares in favor of SCK, for a total value of 10% of P&E's equity.

The preferred shares that SCK received have the following characteristics:

- (i) They generate a variable annual payment of 8% of P&E's after taxes profits, plus a fixed amount corresponding to 12% of the nominal value of the preferred shares. If the accounting period leaves no profits, the fixed amount will be accumulated in the following years until the company produces enough profit to pay SCK fixed fees, accrued both in any preceding or present year.
- (ii) They will be redeemed within a term of fifteen (15) years for their intrinsic value. The intrinsic value is the result of taking the net equity of the taxable year, prior to the redemption date, and dividing it by the number of shares. The redemption value may not exceed five times the nominal value.

(iii) They do not entitle their owner to vote.

Bearing in mind the foregoing aspects, on March 31st, 2017, P&E distributed profits (dividends) of the same year to SCK for a total amount of \$10 million sombrepesos.

- C. Ivan Karamazov, is SCK's star juggler. His presentation is the central attraction of the Circus. Taking into account that SCK reserves the right to modify the decisions taken by its contractors, when the latter do not conform to the artistic philosophy of SCK, Ivan Karamazov is in charge of evaluating the staging prepared by the contractors and, if appropriate, advise them on aspects related to the staging of the show, such as lighting and sound.

For these reasons, SCK has assigned Ivan Karamazov a basic salary of \$5 million sombrepesos plus a technical bonus equivalent to 0.5% of the fee paid by SCK's contractors as agreed in the promoting contracts. This last payment does not take into account if the artist participated in the corresponding shows.

In 2017, Ivan Karamazov also appeared in numerous billboards that were located on the main roads of the capital of Tequiland. These ads were directed both to the promotion of the Circus and to the promotion of other events organized by P&E. Ivan did not received any additional income for this concept, however SCK, was paid \$1 million sombrepesos for the promotion of events not related to the circus show.

III. LEGAL AND CONVENTIONAL FRAMEWORK.

A. Double Tax Treaty (hereinafter "DTT") between Mapleland and Tequiland:

There has been a DTT in force since 2011 (2014 OECD Model Tax Convention). The modifications from the OECD Model read as follows:

ARTICLE 10. DIVIDENDS:

- 1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.*
- 2. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:*

- a) *5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);*
- b) *15 per cent of the gross amount of the dividends in all other cases.*

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. *The term “dividends” as used in this Article means income from shares, mining shares, founders’ shares or other rights, not being debt-claims, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.*

(...)”.

ARTICLE 11. INTERESTS.

1. *Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.*
2. *However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.*
3. *The term “interest” as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage, and in particular income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities,*

*bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.
(...)”.*

B. Domestic Legislation:

Tequiland’s Tax Code sets forth:

“Article 8. Tax resident. *The following companies and entities are deemed as tax residents in Tequiland:*

- 1. Those that during the respective year or taxable period have their place of effective management in Tequiland’s territory.*
- 2. Those that have their main domicile in Tequiland’s territory; or*
- 3. Those that have been incorporated in Tequiland.*

(...)”.

“Article 38. Revenues obtained in the Tequilandian territory.

- 1. The following are considered income obtained in Tequilandian territory:*

(...)

a. The provision of services that are used in Tequiland’s territory, especially those related to the development of studies, projects, technical assistance or management support. When such benefits partially serve economic activities carried out in Tequilandian territory, they shall be considered as obtained in Tequiland only for the part that serves the activity developed in Tequiland.

b. Those derived, directly or indirectly, from the personal performance of artists and athletes, or any other activity related to such performance, in Tequiland, even when they are perceived by a person or entity other than the artist or athlete.

c. The labour income:

1. *When they derive, directly or indirectly, from a personal activity developed in Tequilandian territory (...) "*

"Article 312. Dividends. *Dividends and participations paid by non-resident companies to resident partners, shareholders, commoners, associates, subscribers and similar, do not constitute income in Tequiland"*.

"Article 600. Individuals who are not obliged to present tax returns. *The following individuals are not required to file income tax returns:*

(...)

2. *Non- resident individuals or companies, when all of their income has been subject to withholding tax and said withholding tax has been practiced"*.

Tequiland's legal order does not foresee in its legislation the PE clause, nor general anti-abuse clauses or doctrines.

Tequiland's Commercial Code provides:

"Article 245. Dividends. For purposes of this subtitle, the term dividends means any distribution of property made by a corporation to its shareholders:

1) *Out of its earnings and profits accumulated after February 28, 1916.*

2) *Out of its earnings and profits of the financial year (computed as of the close of the financial year without diminution by reason of any distributions made during the year), without regard to the amount of the earnings and profits at the time the distribution was made"*.

C. Case law:

In application of the definition of article 245 of its Commercial Code, in the year 2000 Tequiland's Constitutional Court decided that the right to participate in the capital of the issuing company and the growth of its assets, as consideration for the risk incurred by the investor, is a criterion to identify dividends. Thus, an investment classifies as capital (deriving in dividends) if the investor must accept the possible risk of loss of the investment in a sense similar to the risk assumed by a shareholder.

According to another decision of Tequiland's Supreme Court of Justice, issued in 2015: "*the classification of debt and capital is based on the definitions provided in commercial and civil law*".

Lastly, multiple cases Tequiland's Supreme Court of Justice has stated that "*those cases that can be labeled as elusion, fraud or fiscal abuse, can only be ruled according to the applicable law, which shall be interpreted in light of the general methods of interpretation and never exceeding the grammatical framework of the same*".

IV. PLEADINGS

In January, 2018, Tequiland's Tax Authority carried out an audit regarding the issues above mentioned and claimed that:

- A. The Tax Authority assessed that SCK conducted a business in Tequiland through a permanent establishment, during the time in which the show was presented. For this purpose, the Tax Administration argued: (i) that it is undeniable that the U4 Arena is a fixed place of business, and (ii) that, according to the promotion agreement, the development of the show was controlled by SCK.
- B. The Tax Administration also argued that the \$10 million sombrepesos received by SCK constitute interest that should be taxed in Tequiland.
- C. The Tax Authority claimed the lack of withholding to Ivan Karamazov for all the income he received in Tequilandian territory, this is, the salary of \$5 million sombrepesos plus a technical bonus equivalent to 0.5% of the fee paid by SCK's contractors as agreed in the promoting contracts. Likewise, the Administration argued that such income would only be exempt from withholding tax if the corresponding DTT had foreseen it.

V. CURRENT PROCEDURE

The case is now pending before Tequiland High Court. The Court in which you are filing the petition (and before which you will later plead orally) only assesses legal arguments. Assume that you are in a rule-of-law country, where rules as well as general principles of law may be invoked. Please note that the Court will not assess any procedural issue.