

**CLARIFICATIONS FOR THE CASE
VII Iberoamerican Tax Moot Court Competition
2018**

In accordance with Paragraph 5.6 of the “Official Rules of the Iberoamerican Tax Moot Court Competition”, that establishes:

“(...) all the requests for clarifications on the case shall include a short explanation justifying the importance of the clarification. Any request which does not contain such explanation shall be ignored”.

The clarifications requests that did not contain such explanation have been ignored.

1. Which taxable years are covered by the tax audit?

The tax audit covers fiscal year 2017. However, Tequiland’s Tax Administration argues that SCK has had a PE in its territory since 2015.

2. Tequiland considered developed or developing countries?

Tequiland is an isolated country, known for the production of avocados, beverages and political turbulences.

3. Are Mapleland and Tequiland considered Civil Law or Common Law countries?

This question is clearly answered in the case. Please read the case carefully.

4. What is the relation between domestic law and international law under Tequiland’s law system? Does Tequiland Constitution authorize treaty override?

Tequiland’s High Court has held that the Constitution provides a moderated monist system. There is no precedent of treaty override in the country, however the Court has also stated that treaties are *lex specialis*.

5. Are Mapleland, Tequiland and Hamburland signatories of the Vienna Convention on the Law of treaties and the General Agreement on Tariffs and Trade?

Vienna Convention on the Law of Treaties and the General Agreement on Tariffs and Trade were ratified by Mapleland, Hamburland and Tequiland.

6. Are the relevant countries (Mapleland, Tequiland and Hamburland) members of the OECD and parties of the Vienna Convention on the Law of Treaties?

Yes. Read answer to question 5.

7. Did Tequiland, Mapleland or Hamburland make any reservations to the 2014 OECD Model Tax Convention? Is there case law applying the commentaries in any of those countries?

No. No, there is no precedent of that sort.

8. Is there a DTT in force between Hamburland and Mapleland following the OECD Model Tax Convention?

No.

9. Did Tequiland and Mapleland establish Mutual Agreement Procedures in terms of articles 10 (2) and 11 (2) of the DTT?

Stick to the facts of the case.

10. Does Tequiland tax interests and/or dividends obtained by non-resident taxpayers when they are borne by resident taxpayers? If so, does the legislation in place provide any specific concept for interests and/or dividends? What may the tax treatment of both items of income be?

Please consider that article 312 of Tequiland's Tax Code refers to inbound dividends. Additionally, take into account that the domestic law in Tequiland includes other articles, which shall be analyzed for this case:

"Article 313. Domestic Dividends: Dividends and participations paid by resident companies to resident partners, shareholders, commoners, associates, subscribers and similar, are not taxed in Tequiland if said dividends are paid to companies.

Article 314. Outbound Dividends: Dividends and participations paid by resident companies to non-resident partners, shareholders, commoners, associates, subscribers and similar, are subject to income tax in Tequiland.

Outbound dividends are subject to a withholding tax rate of 5%.

Article 315. Notional interest deduction: Resident companies can deduct notional interest from their income-tax-base. Notional interest is deemed to be incurred on the company's risk capital, under the following rules:

- (a) It is deductible the notional interest rate which corresponds to the official inter-bank rate certified by the Government for each taxable year;
- (b) Risk capital is any equity and corporate right issued by the entity;
- (c) Any debt-claim will give rise to notional interest deduction;
- (d) Notional interest deduction is not applicable if the income is not included in the recipient's Residence State".

The certified notional interest rate was 5% for the taxable year 2016.

Mapleland's tax law provides that to the extent that a hybrid mismatch results in a deduction in a third country, without inclusion in the taxable base of a resident taxpayer, the participation exemption is not applicable, and therefore, it is switched to a direct tax credit. It is proved that SCK includes in its tax returns the yields from the preferred shares as an exempted income.

11. According to article 312 from Tequiland's Tax Code, *[d]ividends and participations paid by non-resident companies to resident partners, (...) do not constitute income in Tequiland. Since the case factual structure would only be operational should this article be considered in reverse, might we consider article 312 in this sense?*

Read answer to question 10.

12. Regarding the location of SCK's shows and Ivan Karamazov:

- a) Are shows carried out twice a year in each one of the states, as it happens in Tequiland? If so, do aforesaid shows take place consecutively during April and November up to 4 shows per month in 4 different countries?**

The tours were carried out twice a year exclusively in Tequiland during 2015, 2016 and 2017. Additionally, the promoting agreement between P&E and SCK states that if the latter decides to carry out tours in the Kanguron Continent from 2018 to 2020, said tours must take place in Tequiland.

b) In which States is Mr. Karamazov physically present during the taxable years covered by the tax audit? How many days does he spend in which one of them?

Ivan Karamazov spends 2 weeks each year in the country where the tours are held, *i.e.* Tequiland from 2015 to 2017, 2 months each year at Las Vetas, Helada, where the permanent shows take place, and the rest of the year he travels from Mapleland to other countries performing networking activities, such as scouting for new contractors and analyzing the competitors' performances.

13. Concerning the nature of the technical work executed by Ivan Karamazov on the evaluation of staging preparation by the contractors: Is Mr. Karamazov limited to transmitting SCK's performative aesthetics or is he allowed to add his own creative input?

Ivan Karamazov is allowed to introduce his creative vision in the advice he gives SCK's contractors.

14. In relation to the adverts featuring Ivan Karamazov, directed to the promotion of other events of P&E, are those other events related to any kind of public performative activity, which may involve his condition as an artist?

Ivan Karamazov's contract with SCK includes an exclusivity clause for the development of performative activities.

15. Concerning the preferred shares issued on November 2016:

a) On the 12% fixed-rate, is it subjected to variations due to future issuances of this same class of shares?

There is no provision under the bylaws, neither in shares prospectus regarding the future issuance of shares.

b) Should P&E liquidation occur, will SCK have the right to be satisfied in advance, or will it have to claim its share in the distribution of the company's net profit? Does SCK have the right to participate in P&E's hidden reserves?

Under the Commercial Code, shareholders of every kind have the right to participate on the liquidation proceeds. This Code also provides that preferred shareholders have a preferred right to be satisfied for the nominal value of the preferred shares, before the payment of other ordinary shares and after the all the debt are paid. The P&E bylaws and the commercial agreement states the following clause: "Liquidation Events: After payment of the Liquidation Preference to the holders of the Preferred

Shares, the remaining proceeds shall be distributed among all Shareholders in proportion to the nominal value of the Shares held by each Shareholder, provided that the holders of Preferred Shares will stop participating once they have received a total amount per share equal to five times the invested amount [plus any accumulated and unpaid dividends]. Thereafter, the remaining proceeds shall be distributed among the holders of the Common Shares.”

c) What is P&E debt to equity ratio in each taxable year?

2015: 1/1

2016: 0,8/1

2017: 0,8/1

It is worth to notice that Tequiland does not have thin capitalization rules.

d) Regarding the 10% SCK’s participation in P&E: does the nominal value of the shares equate to 25 million sombrepesos at the time of subscription of the commercial agreement? Were it not, what would the nominal value of the aforementioned shares be?

Yes, the nominal value of the shares equate to 25 million sombrepesos at the time of subscription of the commercial agreement.

e) With respect to the distribution of 10 million sombrepesos: what is the proportion derived from the fixed tranche and which one corresponds to the variable fraction? What is the nominal value of the shares at the time of the distribution?

Read answer to question 15.

16. What is the tax treatment granted for dividends and interests paid by companies resident in Tequiland for corporate income tax purposes? Are they deductible against the resident company's tax base? In particular, which was the specific tax treatment conferred to the 10 million payment made by P&E?

Read answer to question 10.

Under the domestic law, interest arising in Tequiland is subject to a 15% withholding tax. Interest paid by companies resident in Tequiland is fully deductible for corporate tax purposes.

17. According to the 2016 commercial agreement in relation to the preferred shares, would SCK lose its entitlement to the variable annual payment of 8% corresponding to those years in which P&E does not report any after taxes profits definitively?

The 2016 commercial agreement provides that SCK would not lose its entitlement to the variable annual payment of 8% corresponding to those years in which P&E does not report any after taxes profits definitively.

18. May you go into more detail regarding the nature of the activities that took place on the warehouse both during the shows and over the whole assessed taxable year(s)?

Qualifying these activities either as of mere preparatory character or as essential activities for the business which is wholly or partially carried thereat would be of key importance when categorizing the above-mentioned activities as "PE", art 5(1), or as exempt activities, under the OECD Model Tax Convention, art 5 (4).

The warehouse was exclusively used to store heavy equipment during the time SCK artists were not present in Tequiland.

19. According to the promoting agreement, is P&E entitled to the proceedings from both the box office and broadcasting of the shows in Tequiland?

P&E is entitled to the proceedings, earnings and profits from both the box office and broadcasting of the shows in Tequiland.

20. Does the distribution of 10 million covers all the amount due (8% of profits + 12% of nominal value) or if it is not sufficient to cover it and what the role played by P&E for the generation of that amount is, namely, without considering the earnings from the broadcasting of the show, is P&E suffering losses or making further profits and what is the amount?

There is no proof of Ivan Karamazov holds shares in SCK, nor of him exercising control or influence over the company, different from artistic matters.

21. On the same paragraph, we would like to know if the wording "of the same year" refers to 2016 or 2017. In particular, it is not even clear when the financial year ends (December, March, other months?).

The taxable year starts on January 1st and ends on December 31st.

The distribution made on March 31st, 2017 corresponds to profits generated in the taxable year 2016.

22. Please clarify the wording of article 245 concerning dividends. In particular, what do the last two lines refer to?

Said rule provides that dividends are the result of the distribution of profits accumulated during a closed period (the financial year) and approved as per the financial statements.

23. Regarding SCK, where does the board of directors meetings take place? How often do they meet?

Stick to the facts of the case.

24. Has SCK actually exercised its right to intervene in decisions made by P&E in relation to the performances? If so, is this intervention only related to artistic matters or it includes business and profitability matters?

Yes, SCK has intervened in relation to artistic matters.

25. Is SCK fiscal resident in Mapleland due to: (a) main domicile or (b) place of effective management and/or (c) incorporation? The financial flows between P&E and SCK occur from Tequiland to Mapleland?

Stick to the facts of the case. P&E pays SCK for the promoting rights.

26. Regarding the following excerpt: “(...) 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”, did SCK actually use the warehouse left at its disposal between 2015 and 2017?

Read answer to question 18.

27. Who are the SCK controlling shareholders and where are they considered tax residents?

SCK’s shareholders are residents in Mapleland.

28. Which activities are performed in Hamburland by SCK and by Ivan Karamazov? Are there only shows or also business meetings? The artists are contracted in Mapleland or in Hamburland?

SCK has a permanent show staged in Hamburland. However, Ivan Karamazov only participates in this permanent show during the 2 months that he is present in Hamburland each year.

The Company does not hold meetings at Hamburland.

29. Did P&E practice tax withholdings in favor of Tequiland when remunerating SCK for the main agreement and paying the \$ 10 million sombrepesos? If so, which rates have been applied?

No withholding was applied to any of said concepts. In relation to the \$10 million sombrepesos paid to SCK, P&E invoked article 24 of the DTT.

30. Does Ivan Karamazov participate in SCK equity? If it's the case, what is his share in the equity? Is it sufficient to control the company? If it is not, is Ivan empowered and does actually exercise influence over SCK's decisions?

There is no proof of Ivan Karamazov receiving equity participations from SCK nor of him exercising control or influence over the company, different from artistic matters.

31. Are the activities performed by Ivan Karamazov (evaluation and advising of the stage prepared by the contractors) strictly related and bound to SCK's contractual right to intervene in the decision made by P&E?

Read answer to question 13.

32. In which frequency Ivan Karamazov's basic salary and technical bonus are paid? What is the financial source of those payments?

The salary is paid on a monthly basis and the bonus is paid annually. Both payments are taken from SCK's global earnings.

33. Is the sum of \$ 1 million paid by P&E to SCK in 2017, regarding the promotion of events not related to the circus show, embedded in the annual \$ 50 million?

Yes.

34. Has Ivan actually assigned images rights to SCK? If so, is there any agreement between SCK and P&E regarding the exploitation of Ivan's image rights?

Ivan Karamazov has not assigned images rights to SCK, nor to any other entity.

35. Did SCK practice tax withholdings in favor of Mapleland when remunerating Ivan Karamavoz for the evaluation and advising related to the staging of the show?

SCK applied the domestic withholding tax provided in Mapleland's Tax Code for labor income.

36. For the matters of determination of the fiscal year in Tequiland, does it correspond to the calendar year?

Read answer to question number 21.

37. Exactly when has the contractual default happened in 2016?

April 2016.

38. When it is described that there is an establishment at SCK disposal in Tequiland, is it their own real estate property? Is it a lease agreement? How long is this lease agreement? Does it has any penalty considering the suspension of the contract? How much does it represent in the total of value of the contract?

The establishment at SCK's disposal in Tequiland is granted by P&E as an obligation derived from the promoting agreement.

39. Who is responsible for the payment of the lease (if it is the case) or is the owner of the establishment used to keep the production inventory in Tequiland?

SCK is responsible for the payment of the lease.

40. Do local Tequiland laws discipline about the permanent establishment? What do the rules determine regarding this aspect?

Tequiland's domestic law includes the PE as a connecting factor following the same wording than the 2010' OECD Model

41. The payment of \$25 million sobrepesos refers to royalty, service or image right? Is it a combination of those revenues established in the contract agreement?

This question is a part of the exercise.

42. The payment of \$10 million sobrepesos is considered fixed installments? If so, can this payment be considered interest?

This question is a part of the exercise.

43. The portion of 0.5% that must be given to Ivan Karamazov is considered dividends? If not, what is the nature of this portion?

This question is a part of the exercise.

44. “Profits” and “earns”, following the OECD disposition, can be considered the same thing?

This question is a part of the exercise.

45. What is the relation between Ivan Karamazov and SCK? Is he a shareholder, a director, an officer, an independent contractor or an employee?

Read answer to question 29.

46. What are the rules regarding residence in Mapleland? That is, what are the criteria that define SCK as a fiscal resident of Mapleland?

Stick to the facts of the case.

47. At what rate do Mapleland, Tequiland and Hamburland tax income derived by their residents? Are they (or some of them) qualified as tax havens?

None of said countries are tax havens. Mapleland: 21%; Tequiland: 30%; Hamburland: 21%.

48. Is there a Double Tax Treaty between Mapleland and Hamburland? If so, are there any provisions different from the OECD Model Tax Convention?

Read answer to question 8.

49. With regard to SCK’s structure and activities: who is part of the SCK crew, what kind of activities do they perform (is it strictly performing arts?) and what is their relation with SCK (are they mere employees etc.)? Does the lighting and sound equipments in the warehouse belong to SCK? If not, to whom?

Only high-level artists are part of SCK’s crew and they strictly perform as artists. Yes.

50. What type of decisions can be made by P&E and will all of them be subjected to SCK's interference?

SCK is entitled to intervene in the activities developed by P&E before, during and after each presentation, in order to protect its precious intangibles and its institutional values. For example, SCK has intervened in the design of the ticket office, the forms and means of promotion, all the configuration of the stage, the maximum number of attendees, bleachers, order of the artistic presentations, types of services and goods that are offered to the public (souvenirs, food and drinks). SCK demands P&E the strictest compliance to SCK's standards, particularly those related to labor and consumer protection.

All other decisions are taken P&E without any intervention. For example, the value of the ticket office, financial and administrative organization.

51. Which company did derive the box office revenue (\$120 million sombrepesos per year)? If P&E did so, did the company derive any other income or revenue from 2015 to 2017? If so, how much, for what activity and from what source?

P&E. Yes, the company obtains interest from the promotion of other events. However, the revenue derived from the promotion of SCK's show is the 50% of P&E's annual income.

52. Does the new commercial agreement entered into by SCK and P&E on November 30th, 2016 establish what shall happen if, before the term of fifteen (15) years, P&E is liquidated?

Under the Commercial Code, shareholders of every kind have the right to participate on the liquidation proceeds. This Code also provides that preferred shareholders have a preferred right to be satisfied for the nominal value of the preferred shares, before the payment of other ordinary shares and after the all the debt are paid. The P&E bylaws and the commercial agreement states the following clause: "Liquidation Events: After payment of the Liquidation Preference to the holders of the Preferred Shares, the remaining proceeds shall be distributed among all Shareholders in proportion to the nominal value of the Shares held by each Shareholder, provided that the holders of Preferred Shares will stop participating once they have received a total amount per share equal to five times the invested amount [plus any accumulated and unpaid dividends]. Thereafter, the remaining proceeds shall be distributed among the holders of the Common Shares."

Please be aware of the Commercial Code's definition of preferred shares and the P&E bylaws rules with respect to dissolution and liquidation stated in the clarifications (question 15, b). If P&E were to be terminated, SCK as an owner of

preferential stocking would receive its share in the terms described in the agreement. This is, without prejudice of applying credit ranking and other rules of bankruptcy law.

53. Did Tequiland, Hamburland and/or Mapleland sign the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI)*?

All countries have signed the MLI but it has not being ratified in neither of them. The DTT between Tequiland and Mapleland is a covered treaty. Both countries used all the possible reservations under the MLI.

54. Is SCK liable in any circumstance for any losses incurred by P&E?

No. Read answer to question 15.

55. What shall happen if, at the end of the fifteen (15) year period, P&E has not paid the \$25 million sobrepesos owed to SCK yet?

The obligation implies the payment that may be demanded as a debt of third parties and lead to the liquidation of the company.

56. In what manner will P&E distribute profits to its shareholders and creditors? Is there an order of preference and, if so, what is SCK's position in such order?

SCK would have a preferential position, without prejudice of the credit ranking foresaw in the law.

57. What is the withholding tax rate applicable to dividends and interests derived from Tequiland according to its domestic legislation?

5% and 15%, as stated above.

58. Is the new commercial agreement between SCK and P&E characterized as a novation? That is, does it extinguish the old debt and creates a new one?

Yes, as a result the old obligation is extinguished and a new obligation is created.

59. What is and how much is the nominal value of the preferred shares issued by P&E in the context of the new commercial agreement between SCK and P&E? Does this nominal value change through the years?

Read answer to question 14. The nominal value does not change.

60. What is P&E's capital at the moment of the preferred shares issuance? Does it change through the year?

P&E's capital is \$ 250,000 million at the time of issuance and does not change after the capitalization.

61. Were there any provisions, in the original agreement between SCK and P&E, regarding penalties and/or fines in the event of late payment?

No, the breach was not foreseen. SCK did not charge interest from the moment of enforceability and capitalization.

62. Does SCK have an administrative/operational structure and/or employees in Hamburland? What are the criteria of tax residence according to Hamburland's domestic legislation?

There is only one operational structure, but as it is clearly stated in the case, SCK is not resident in Hamburland.

63. During the relevant period (2015 to 2017), did SCK perform artistic shows in any locations other than Tequiland? Is there an exclusivity clause in its contract with P&E?

Read answer to question 12.