Bloomberg Tax

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Comparative Tax Law for the International Practitioner

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Tax Reporting Units and Permitted Consolidation

Background

F is an ownership arrangement formed under the laws of a foreign country (and considered a "corporation" for purposes of that country's income tax laws). F has sent its Vice President for Operations to Host Country to promote F's business interests there. In so doing, the Vice President has formed a number of different ownership arrangements under the business law of State X, a political subdivision of Host Country. Some of these ownership arrangements look like typical business law corporations and partnerships (as those terms are generally understood), and some appear to be unique to State X's business law. The Vice President has also entered into, on behalf of some of the newly formed ownership arrangements, a number of informal ownership arrangements with unrelated parties. One such arrangement involves joint ownership of a warehouse. Each owner will use part of the warehouse space to store its own merchandise, and non-allocated space will be leased to non-owners from time to time.

Questions

1. For purposes of Host Country's income tax law, how does one determine whether an ownership arrangement constitutes a tax reporting unit (assuming it has the requisite amount and type of income) and its classification for tax purposes (for example, corporation or partnership) if it does constitute a tax reporting unit?

2. Does Host Country's income tax law permit consolidation of the income/losses of any tax reporting units and, if so, what are the general rules pertaining to: (a) such consolidation; (b) liability for the consolidated tax (for example, do the various units have joint and several liability?); (c) how units must contribute to payment of the consolidated tax; and (d) how units must compensate other units for the use of losses, credits, and other tax attributes that serve to reduce tax?

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ARGENTINA: Tax Reporting Units

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I. Rules relating to the determination and classification of tax reporting units

The Argentine Income Tax Law (ITL) has different rules for determining which entities or ownership arrangements are treated as separate taxable entities, depending on whether the entity concerned is organized, incorporated or domiciled in Argentina or in a foreign country.

A. Entities or ownership arrangements organized or incorporated in Argentina

For income tax purposes, tax reporting units are those listed in Section 69, paragraphs a) and b) of the ITL. All these entities and ownership arrangements are treated as separate taxable entities, and therefore must register with the tax authorities, file annual income tax returns and remit the resulting tax liability. The list includes most types of business entities, as well as other types of ownership arrangements. Tax reporting units include:

- Corporations (*sociedades anónimas*), stock partnerships (*sociedades comanditas por acciones*), limited liability partnerships (*sociedades de responsabilidad limitada*) and simple partnerships (*sociedades en comandita simple*) incorporated or created in Argentina;
- Civil associations, foundations, cooperatives, and civil and mutual entities created in Argentina;
- Companies with both state and private shareholders (*empresas de economía mixta*);
- Entities subject to Law 22.016 (state enterprises);
- Trusts created in Argentina, except where the settlor is also a beneficiary of the trust (this exception does not apply to financial trusts);
- Common investments funds created in Argentina, except those included in the first paragraph of Section 1 of Law 24083;
- Other entities that choose to be treated as tax reporting units; and
- Permanent establishments (PEs) of nonresident entities or individuals.

Unlike other countries, Argentine has a uniform civil and commercial law and, therefore, all types of business or civil entities and the different types of ownership arrangements are regulated by national laws that apply throughout the country. This feature of Argentine law eliminates many of the issues that other federal countries face relating to the proper classification of entities organized under local or state laws, and allows a listing of the entities that are taxed separately from their owners or members, instead of requiring the use of a more conceptual approach to define such entities.

Argentina does not allow entities listed in Section 69 of the ITL to opt not to be treated as tax reporting units. On the other hand, an entity not included in the list may elect to be treated as a separate taxable unit. However, to be able to make such an election, the entity concerned must keep accounting records that would allow the preparation of commercial financial statements and must abide by the election for a period of not less than five years.

All the entities listed in Section 69 are treated as separate taxable entities from the date of their incorporation or creation, except entities that make the election referred to in the previous paragraph, in the case of which the election is effective as from the next taxable year.

Section 69 encompasses trusts and certain common investment funds, which are ownership arrangements that are not entities for legal purposes. An entity for legal purposes is an entity that, under the law, has legal personality, meaning the ability to acquire rights and obligations in its own name. Legal personality does not necessarily entail the limitation of the liability of the members or owners.

Entities not listed in Section 69 are treated as pass-through entities for tax purposes. This treatment applies to general partnerships (*sociedades colectivas*) and non-typical entities (*sociedades no constituidas conforme a uno de los tipos previstos*). A pass-through entity may have a taxable year different from the calendar year and must determine a tax result, which is then deemed to be distributed to its members or partners in proportion to their interests in the entity. The members or partners must then include their deemed distributed share of the tax result on their income tax returns as part of their taxable income or loss.

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Other ownership arrangements, such as *Uniones Transitorias de Empresas* (UTEs) or simple co-ownerships, are transparent for income tax purposes. This means that, unlike pass-through entities, such other ownership arrangements do not determine a tax result and any revenues they earn are treated as earned directly by their members in proportion to their interests in the arrangements.

B. Entities or ownership arrangements organized under foreign law

The rules with respect to foreign ownership arrangements or entities are contained in Section 133 of the ITL, which lays down the attribution rules in accordance with which Argentine partners, owners or shareholders must include foreign income in their Argentine tax returns.

Section 133 governs the following cases:

(1) Income derived from a foreign PE of an Argentine resident: this is taxable in the hands of the Argentine resident in the year in which the taxable year of the PE closes, whether or not there is a distribution of profits.

(2) Income of a trust, private foundation or similar arrangement, including any arrangement under foreign law for the administration of assets, that is controlled by an Argentine resident: this is taxable in the hands of the Argentine resident in the fiscal year in which the taxable year of the trust, foundation or arrangement closes. The law provides that for these purposes control is deemed to exist when the assets concerned remain under the control or administration of the Argentine resident, including in the following situations: (a) when the trust or foundation is revocable; (b) when the grantor is also a beneficiary; and (c) when the Argentine resident has, directly or indirectly, the power to invest or divest the assets.

(3) Income derived by a foreign entity that is not treated as a taxable entity in its jurisdiction of residence: this is taxable in the hands of its Argentine resident members in the year in which the taxable year of the foreign entity closes.

(4) Income derived from a foreign entity that is not covered by (1), (2) or (3), above: this is taxed in the hands of its Argentine resident shareholders or members in the year in which the taxable year of the foreign entity closes if: (a) Argentine residents control, directly or indirectly and according to specific attribution rules prescribed in the ITL, 50% or more of the capital, income or votes of the foreign entity; (b) the foreign entity does not have its own personal and material resources, or 50% or more of its income is passive income or is derived from revenues that constitute deductible expenses for Argentine residents; and (c) the tax paid on the income referred to in (b) is less than 75% of the tax that would be payable in Argentina on such income under Argentine tax rules.

Income derived from an entity that does not fall within any of the categories discussed above (for example, income from a foreign business entity that is treated as a taxable entity in its jurisdiction of residence but does not meet all the three requirements referred to above in (4)) is taxable only when it is distributed in the form of dividends to Argentine residents.

An issue may arise in relation to the possible application of these rules to an entity that qualifies as a resident of a country that has a tax treaty with Argentina, the rules being in possible conflict with treaty Articles 7 and 10, under which, respectively, business profits are taxable only in the Contracting State of residence of the enterprise concerned (unless the profits are attributable to a PE of the enterprise in the other state) and the other state is allowed to tax only when the profits are distributed as a dividend to a resident of that other state.

It should be noted that the above rules apply only to determine when income derived by a foreign entity or ownership arrangement is taxed in the hands of its Argentine partners, owners or shareholders; if any such entity derives income from Argentine sources in its own name, such income will be subject to Argentine withholding tax at source when paid.

II. Rules relating to permitted consolidation

Argentine tax law does not permit the consolidation of the income/losses of entities treated as separate taxable entities under Section 69 of the ITL. Thus, each entity must determine and pay its own tax, and use its own tax attributes, such as accumulated tax losses and tax credits.

The tax attributes of such entities may be transferred only in the context of a tax-free corporate reorganization (i.e., a merger, a spin-off or a transfer of assets between entities that are members of the same economic group).

With respect to entities treated as pass-through entities, the ITL provides that their tax results (income or loss) are deemed to be distributed to their members in proportion to their respective participations and the members must include their deemed distributed shares in the results in their tax returns, and ultimately may set off such shares with income or losses from other sources. However, such set offs are not allowed with respect to ring-fenced losses (i.e., losses on the sale or disposition of shares or other securities, foreign-source losses, and losses incurred with respect to speculative derivative transactions).