

## Deduction of intragroup charges in Argentina

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The topic of intragroup services is discussed in the recent case involving 'Italtel S.P.A. Argentine branch'<sup>1</sup>. The main focus of the case is the deduction for income tax determination at the level of a branch of expenses charged by the headquarters in Italy.

The activity of the Argentine taxpayer was the turnkey provision, installation and configuration of telecommunication equipment for telephone operators and the provision of technical assistance, training and equipment repair.

### 1. Green light to direct allocation

The items in question corresponded on one hand to various concepts such as research, development, maintenance, and support in connection with the software included in the commercial solution offered by the branch. The service charge was based on the hours effectively incurred by the headquarters on each order attributed to the Argentine branch.

The Court confirmed the deductions of such expenses on the grounds that they had been accurately registered in the accounting records and proved that the headquarters' activities were linked to the results of the permanent establishment 'in view of the correspondence between the business operations conducted by the branch and the detailed description of the activity of the headquarters that relates to the branch income-producing operations' with 'a break down of hours worked, personnel cost, methodology for calculating the total billed charges and specific activities'.

### 2. Indirect allocation challenged

Other issue featured in the Italtel case included administrative services performed by the headquarters such as 'president', 'external and institutional relations', 'human resources', 'strategic planning', 'legal and corporate affairs', 'administration and accounting', 'finance and treasury', 'internal audit', 'procurement', 'supply chain', 'management control', 'ISO 9000 quality certification', 'logistics' and 'trade' among others brought together under the name of 'management, general and administrative expenses'.

The remuneration of these concepts was calculated based on a cost allocation considering the percentage of the Argentine branch's turnover over the global turnover of the multinational group.

The Court decided to follow the archaic precedents *in re*: 'First National City Bank'<sup>2</sup> and 'Citibank NA'<sup>3</sup>, which denied the deduction of expenses incurred by the headquarters allocated through a mathematical apportionment, instead of the Italian Court of Cassation case No. 14016 (cited by the Court in its decision) which in the context of 'indirect' expenses focused on whether the services were provided at a fair value as compared to normal costs. The Court followed a formalistic approach as in the case 'J. Walter Thompson Argentina SA'<sup>4</sup> and confirmed the tax authorities position.

While the decision acknowledges that 'the headquarters must have incurred expenditures to direct, control, manage, etc. its Argentina branch', 'recognition of a portion of the general, administrative and management expenses at the permanent establishment level requires a criteria of reasonable linkage'.

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<sup>1</sup> 'Italtel S.P.A. Sucursal Argentina s/ apelación Impuesto a las Ganancias', Federal Tax Court, Room 'B', 20 April 2015.

<sup>2</sup> 'First National City Bank c. Fisco Nacional (DGI) s. repetición', Federal Administrative Court of Appeals, Room II, 13 September 1979.

<sup>3</sup> 'Citibank N.A. c. Fisco Nacional – DGI s. repetición', Federal Administrative Court of Appeals, Room I, 8 August 1985.

<sup>4</sup> "J Walter Thompson Argentina S.A.", Federal Administrative Court of Appeals, Room I, 24 August 2006.

The Court analyzed the double tax convention between Argentina and Italy, which refers to the deduction of expenses incurred for the purposes of the permanent establishment, including general, administrative and management (art. 7, p. 3), with the clarification included in the Protocol that it is understood by those directly linked to the activity of that establishment.

Under the Court's opinion, there is not a substantial but merely a probatory distinction between 'direct' and 'indirect' expenses, and then it found that the mathematical apportionment does not comply with the Protocol criteria and therein lies the main reason why the deduction should not be allowed.

### 3. Conclusion

The position of the Court on the Protocol's requirement that the expenses must be 'directly' linked to the activity of the permanent establishment, result in an aggravation of the tax position of the branch from that of other companies resident in Argentina.

Rejecting the deduction of expenses for services to the Argentine branch, which had not been provided by the headquarter should have been obtained from an external provider or by the permanent establishment itself, violates the non discrimination clause of the Double Tax Convention between Argentina and Italy.

Irrespective of whether it was a mathematical formula apportionment, based on the arm's length standard, the debate should have been restricted to the determination of the amount that should have been paid by the branch having contracted the activity out to a third party or carried out internally- in other words, conforming to the transfer pricing rules.