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ARGENTINE BUSINESS ENTITIES AND THE U.S. CHECK-THE-BOX REGULATIONS

*Daniel H. Dicásolo**

I. INTRODUCTION

IN general terms, U.S. tax law classifies a foreign entity as one of the following: (1) a corporation, (2) a partnership, (3) a fiduciary (an estate or a trust), or (4) a disregarded entity.¹ Each category has different tax consequences, making it important for an American investor to know (prior to setting up a foreign entity) how that foreign entity will be treated under U.S. tax law. Further, it should be taken into consideration that classifying a domestic entity is easier than classifying a foreign one, simply because the latter involves unfamiliar foreign law. Once the foreign entity's structures have been analyzed under the law of the country involved, the next step is to assess those entities under U.S. tax law, and, in many cases, under the U.S. check-the-box regulations. These rules provide an elective regime for classifying certain business organizations in order to establish their tax treatment in the United States. Under this system, certain entities are automatically treated as corporations, while others are allowed to select whether to be taxed as a corporation or as a partnership.² In addition, "a single-member unincorporated entity may be disregarded as an entity separate from its owner."³

This article briefly discusses the major Argentine business entities and examines their possible U.S. tax classifications under the so-called check-the-box regulations. This will provide some guidance to an American investor wanting to structure an entity in Argentina.

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1. Treas. Reg. § 301.7701-2(a) (as amended in 1996).

2. Franchise Tax Board, Analysis of SB 1234 (Aug. 25, 1997), http://www.ftb.ca.gov/law/legis/97_98bills/sb1234.pdf.

3. *Id.*

II. UNITED STATES CLASSIFICATION OF BUSINESS ENTITIES PRIOR TO THE CHECK-THE-BOX REGULATIONS

Prior to the check-the-box regime, business entities were classified under the Kintner regulations. Although the Internal Revenue Service initially considered unlimited liability as the primary factor for the taxation of partnerships, its final position on the matter is to have "tax classification based on the presence of 'corporate' characteristics defined in the Kintner regulations."⁴ In sum, the IRS

classified an organization based on six factors: (1) associates, (2) objective to carry on business and divide the profits from the business, (3) continuity of life, (4) centralization of management, (5) limited liability, and (6) free transferability of interests. Because the first two characteristics were common to associations and partnerships, only the last four factors were relevant in determining whether an entity would be classified as an association or as a partnership. If there was a preponderance of the last four factors (more than two), then the entity would be classified as an association; otherwise, the entity would be taxed as a partnership. These same four factors were used to classify foreign entities, which were considered to be unincorporated organizations. In making this determination, the [IRS] stated that local law would control the determination of whether a factor was present.⁵

III. CHECK-THE-BOX REGULATIONS

The Tax Executives Institute opined on the check-the-box regulations implemented under section 7701 of the Internal Revenue Code with the following:

The so-called check-the-box regulations replace the formalistic entity classification rules with a simpler, elective regime. Designed to ease administrative burdens for taxpayers and the government, the new rules permit taxpayers to elect to treat certain domestic or foreign business organizations as partnerships, corporations, or disregarded entities (*e.g.*, branches) for federal tax purposes. They constitute a bold, innovative approach to resolving the manner in which business entities are classified for tax purposes. The primary benefits of the rules include certainty and a reduction of transaction costs.⁶

Professor Christopher Hanna has summarized the major principles of the check-the-box regulations as follows:

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4. ROBERT W. HAMILTON & JONATHAN R. MACEY, *CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIP AND LIMITED LIABILITY COMPANIES* 189 (8th ed. 2003).
 5. Christopher H. Hanna, *Initial Thoughts on Classifying the Major Japanese Business Entities Under the Check-the-Box Regulations*, 51 SMU L. REV. 75, 86 (1997).
 6. Tax Executive, *Comments on Changes in Entity Classification: Special Rule for Certain Foreign Eligible Entities* (Apr. 4, 2000), http://www.findarticles.com/p/articles/mi_m6552/is_3_52/ai_63639840.

Generally, the regulations place an organization into one of three major categories: “nothing”, trust, or business entity. The first category is disregard of the organization or, in other words, treating the organization as a “nothing”. This category focuses on whether an organization is an entity separate from its owners. Even if the organization is recognized as an entity under local law, it will not necessarily be treated as an entity separate from its owners for federal tax purposes. In addition, “[a] joint venture or other contractual agreement may create a separate entity for federal tax purposes if participants carry on a trade, business, financial operation, or venture and divide the profits” from it.⁷

For example, “a separate undertaking exists for federal tax purposes if co-owners of an apartment building lease space and in addition provide services to the occupants either directly or through an agent. Nevertheless, a joint undertaking merely to share expenses does not create a separate entity for federal tax purposes.”⁸ Also, “certain organizations that have a single owner can elect ‘to be recognized or disregarded as entities separate from their owners.’”⁹

Professor Hanna further analyzes the regulations as follows:

If a separate entity exists, then the next issue to consider is whether it is classified as a “trust under [Treasury Regulation] § 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code” (such as real state mortgage investment conduit (REMIC) or a qualified settlement fund (QSF)). If the separate entity is not classified as a trust or otherwise subject to special treatment, then it will be considered a business entity.¹⁰

A business entity will fit into one of two subcategories. It may automatically be treated as a corporation for federal tax purposes. Business entities automatically classified as corporations include domestic corporations, insurance companies, certain banks, and certain foreign entities that are listed in the regulations.

If a business entity is not automatically a corporation, then it is an “eligible entity.” An eligible entity with at least two members can elect to be classified as an association (and therefore a corporation) or as a partnership. An eligible entity with only one member “can elect to be classified as an association [and therefore a corporation] or to be disregarded as an entity separate from its owner.”¹¹ [Additionally,] if the business entity is disregarded because it has one owner, it will be treated in the same manner as a sole proprietorship, branch, or division of the owner.¹²

If an eligible entity does not make an election, then a default rule applies. The default classification for a domestic eligible entity is partnership if it has two or more members and it is disregarded as an

7. Hanna, *supra* note 5, at 89 (citations omitted).

8. Treas. Reg. § 301.7701-1(a)(2) (as amended in 1996).

9. Hanna, *supra* note 5, at 89.

10. *Id.* (citations omitted).

11. *Id.* at 90.

12. *Id.* at 89-90.

entity if it has only one owner. The default classification for a foreign eligible entity is a little more complex. If the foreign eligible entity has two or more members and at least one member does not have limited liability, then it is a partnership. If the members of the foreign eligible entity all have limited liability, then it is an association and therefore, a corporation. If the foreign eligible entity has one owner who does not have limited liability, then it is disregarded as an entity separate from its owner.¹³

In determining whether a member of a foreign eligible entity has limited liability, the statute or law pursuant to which the foreign entity was organized must be analyzed.¹⁴ If the statute or law allows the organizational documents to specify whether members will have limited liability, then the organizational documents must also be consulted.¹⁵ "[A] member of a foreign eligible entity has limited liability if the member has no personal liability for the debts of or claims against the entity by reason of being a member."¹⁶ Personal liability is said to be present "if the creditors of the entity may seek satisfaction of all or any portion of the debts or claims against the entity from the member."¹⁷

IV. THE MAJOR ARGENTINE BUSINESS VEHICLES

Foreign investors may do business in Argentina as individuals or Argentine branches of foreign corporations (*sucursales de sociedad extranjera*), or through any of the various types of local entities governed by the Commercial Companies Law N° 19.550, including corporations (*sociedad anónima*) and limited liability companies (*sociedad de responsabilidad limitado*), as the most common options, and general partnerships (*sociedad colectiva*), limited partnerships (*sociedad en comandita simple*), *sociedad en comandita por acciones*, and *sociedades accidentales o en participacion* as alternative possibilities. The documents needed in order to register local or foreign entities before the Commercial Companies Registry may vary, depending on the type of structure elected and the jurisdiction where the company desires to obtain the registration. Particularly, is important to point out that the Commercial Public Registry of the City of Buenos Aires is currently requiring, through Resolutions 7/2003 and 7/2005, more documents than other jurisdictions in order to register foreign companies.

The *sociedad civil* is organized under the Civil Code and constitutes another choice for setting up a business. Other types of entities like foundations, public corporations, civil associations and non-juridical organizations can be found in Argentina, but they do not belong to the scope of

13. *Id.* at 90 (citations omitted).

14. Treas. Reg. § 301.7701-3(b)(2)(ii) (as amended in 1996).

15. *Id.*

16. *Id.*

17. *Id.*

entities used by private investors to develop profitable activities. As a consequence, they will not be covered in this work.

Foreign corporations often choose to operate in Argentina through separately incorporated subsidiaries, rather than through branches, to minimize their potential liability. If an Argentine or foreign subsidiary is employed, the foreign corporation's liability is generally limited to the assets owned by that subsidiary. In contrast, if a branch is utilized, all of the foreign corporation's assets may be subject to potential liability.

A. CORPORATION (*SOCIEDAD ANÓNIMA* OR SA)

This type of entity is equivalent to incorporated limited liability companies in the United States, the United Kingdom and various other countries (*kabushiki kaisha* in Japan and *aktiengesellschaft* in Germany). It is the only one that can be quoted on the Stock Market Exchange.

The SA is organized under the Commercial Companies Law N° 19.550. Its operation is governed by by-laws (*estatutos*), in which the name, purposes, duration, capital, appointments, and powers of the board of directors, and all other functioning rules are established. The term *sociedad anónima*, which may be shortened to SA, must be included in the corporate name. It is formed by at least two shareholders who can be either corporate entities or individuals, and since there are no nationality or domicile requirements, all shareholders can be foreign residents or companies. Their liability is limited to full payment of the stock subscribed.¹⁸

A minimum capital amount is required (approximately US\$4,000)¹⁹ in the SA. It has to be fully subscribed at the time of formation, and at least 25 percent must be paid upon subscription. The remaining balance has to be paid within two years thereafter, but investments in real estate, equipment, or other non-monetary assets must be contributed in full at the time of subscription.²⁰ The capital is divided into shares, which must be nominative, non-endorsable, and may or may not be represented by certificates (the latter being book entry shares). Common and preferred shares may be issued.²¹ Issuance and ownership of uncertificated shares arise from the records on the shares registry book. Transfer of shares may be subject to restrictions established in the by-laws, but can never be banned²² (in general, they may be transferred freely without obtaining the approval of the remaining shareholders).

The bodies of the SA's are classified into shareholders' meetings, board of directors, and Syndics (or Overseers, if an individual; or Surveillance Committee, if organized as a Committee). The SA is governed by the board of directors,²³ which is elected by the shareholders. Duration of

18. See Commercial Companies Law, art. 163.

19. Commercial Companies Law, art. 186.

20. Commercial Companies Law.

21. Commercial Companies Law, art. 216.

22. Commercial Companies Law.

23. Commercial Companies Law.

their mandates must be established through by-laws, but can never exceed a three-year term with the possibility of being unlimitedly re-elected.²⁴ There is no restriction with regard to the nationality of the directors, but the majority of them must be Argentine residents.²⁵ Within the City of Buenos Aires, directors are required by the Commercial Public Registry to set up before such registry warrantees amounting pesos \$10,000 (approximately, US\$3300). The number of members on the board is determined by the shareholders in observance of the maximum and minimum limits stated in the by-laws, and temporary directors may be appointed by the shareholders to provide for possible vacancies.²⁶ The board of directors is entitled to decide all of the matters not expressly conferred by themselves, by the law, or by shareholders' resolutions to the shareholders' meetings.²⁷ The president is the legal representative of the SA, but joint representation with other directors may be established through the by-laws. A minimum of one director can be appointed. However, if the company has capital over \$2,100,000 Argentine pesos, renders a public service, or owns a public concession,²⁸ it must appoint a board of at least three directors and have a Surveillance Committee. The board of directors must hold meetings at least quarterly and shareholders' meetings must be held at least once a year to approve the year-end financial statements and the performance of the members of the board of directors, to distribute dividends, to pay directors' fees, and to elect the members of the board of directors and the statutory auditors (if necessary).

Under Argentine income tax law, the SA is treated as a separate entity from its shareholders²⁹ and is subject to taxation at the entity level. The applicable tax rate is 35 percent.³⁰ In general, cost and expenses necessary to obtain, maintain and preserve the income generated by the Company will be tax deductible. Unlike the U.S. income tax system, which has a double level of taxation for corporations (first the corporation and then the dividend distributed to the shareholder), Argentine income tax law does not tax the distribution of dividends to the shareholders, unless the dividend exceeds the after-tax accumulated taxable income of the taxpayer, in which case a final withholding tax of 35 percent applies to the excess.³¹

24. *Id.*

25. *Id.*

26. *Id.*

27. JOSE ALBERTO GARRONE & MARIO E. CASTRO SAMMARTINO, *LEY DE SOCIEDADES COMERCIALES, COMENTARIO Y JURISPRUDENCIA* 248 (1998).

28. Commercial Companies Law, arts. 255, 299.

29. INC. TAX L. art. 69 (1999).

30. INC. TAX L. art. 147 (1999). Tax is levied on taxable income, which is the accounting profit earned in the tax period after adjustments provided for by tax law.

31. INC. TAX L. art. 69.

B. LIMITED LIABILITY COMPANY (*SOCIEDAD DE RESPONSABILIDAD LIMITADA* OR *SRL*)

The SRL is similar in many respects to the American limited liability company (LLC) and the Japanese *Yugen Kaisha*. In Argentina, it is organized under the Commercial Companies Law.

The name of the company has to be accompanied by the words "*Sociedad de Responsabilidad Limitada*" or SRL for short. By using an SRL, the interest holders, or named partners, limit their liability to their interest holding or quota.³² The minimum number of partners must be two and shall not exceed fifty;³³ however, an Argentine corporation may not be a partner. Any change of partners requires an amendment to the formation deed, which implies its registration upon the Commercial Public Registry.³⁴

The formation deed, which needs to be duly notarized and registered with the Public Registry of Commerce, determines the functioning conditions of the SRL, its capital structure³⁵ (amount fixed in the founding deed and divided in social units with a nominal value of ten pesos for each one), person in charge of management or management committee, form and frequency of partners' meetings, which have to approve financial statements once a year, and determines the distribution of profits. Within the City of Buenos Aires, directors are required by the Commercial Public Registry to set up before such registry warranties amounting pesos \$10.000 (approximately, US\$3300). The SRL by-laws has to contain all the basic rules to be applied, including those referring to quota transfers, changes in the appointment of managers, and the procedure to amend founding provisions. With respect to quota transfers, it is important to note that they may be restricted by the deed of incorporation but never prohibited,³⁶ and that each of them may be done through an assignment of rights contract and registered in the Public Record of Commerce in order to have effect against third parties.³⁷ The formation deed could determine that partners have to subscribe supplementary quotas of capital, which could be called by the partnership, fully or in part, with the vote of partners representing at least half the social capital.

An SRL may have a statutory auditor, unless the SRL has a capital that exceeds the amount stated in the Commercial Companies Law, in which case the presence of a statutory auditor is mandatory.³⁸

32. Commercial Companies Law, art. 146.

33. Commercial Companies Law, art. 146 (1997). Also, the excess in the number of partners (more than fifty) suggests, under the principle of conservation of the enterprise stated in Article 100 of the CCA, just the nullity of the connection with the partners in excess joined at last. GARRONE & SAMMARTINO, *supra* note 27, at 248.

34. Commercial Companies Law, art. 152.

35. Commercial Companies Law, art. 148.

36. Commercial Companies Law, art. 153.

37. Commercial Companies Law, art. 152. For more comments, see RICARDO AUGUSTO NISSEN, *CURSO DE DERECHO SOCIETARIO* 373 (1998) (on file with author).

38. Commercial Companies Law, art. 299. The amount is approximately US\$700,000.

As stated above, Argentine SAs are forbidden by law to have quotas in an SRL, restricting the use of SRL to small and mid-size business developments. In addition, normally the SRL does not fulfill the governmental requisites concerning calls for bids in concessions and privatizations.

For income tax purposes, the SRL is treated as the SA and is, therefore, subject to taxation (at a 35 percent tax rate) at the entity level only.³⁹ In general, cost and expenses necessary to obtain, maintain, and preserve the income generated by the Company will be tax deductible. The distribution of earnings to the partners is not taxable under the Income Tax Law,⁴⁰ unless the distribution exceeds the after-tax accumulated taxable income of the taxpayer, in which case a final withholding tax of 35 percent applies to the excess.⁴¹

C. BRANCH OF FOREIGN COMPANY (*SUCURSAL DE SOCIEDAD EXTRANJERA* OR *SUCURSAL*)

A foreign company may perform any single permissible transaction⁴² in Argentina. However, to carry on a permanent activity, a foreign company shall register before the Commercial Public Registry a local entity or a branch of a foreign company (*sucursal de sociedad extranjera*). Notwithstanding that according to Argentine law it is the law of the place of incorporation that governs the structure, capacity, and formalities of the entity,⁴³ the result of foreign entities not registered before the Commercial Public Registry is to disregard the foreign entity's performance in Argentina.⁴⁴ In other words, its acts cannot be invoked as acts of the previously mentioned foreign entity.

To register a branch in Argentina, foreign companies must prove before the Commercial Public Registry both their existence and their intention to establish a branch.⁴⁵ In addition, the branch must appoint and register before such registry a legal representative and establish a domicile. Notwithstanding the aforementioned, as seen before, the Commercial Public Registry of the City of Buenos Aires has enacted certain resolutions that impose new and stricter requirements for foreign companies that desire to obtain the registration as foreign shareholders of local entities or as Argentine branches.⁴⁶

39. INC. TAX L. art. 69.

40. INC. TAX L. art. 46.

41. INC. TAX L. art. 69.

42. A single permissible transaction or single act is defined by the legal interpreters as "[t]hose acts which are incidental and with no permanence and continuity. Moreover, for these interpreters this criteria must be applied narrowly." See NISSEN, *supra* note 37, at 315.

43. See Commercial Companies Law, art. 118.

44. NISSEN, *supra* note 37, at 317.

45. Commercial Companies Law art. 118.

46. Basically, under resolution 7/2003 and 7/2005, foreign entities that desire to establish a branch or participate in local entities, must prove before the IGJ that they have assets or that they perform activities outside the Republic of Argentina.

Once a branch is set up, it is treated, mainly for accounting purposes, as an entity independent from its head office, but the latter maintains unlimited liability for the branch debts. The operating capital is often assigned to branches, although it is not required.⁴⁷

For income tax purposes, branches are treated as entities independent from their head offices (they have to keep separate books and records)⁴⁸ and are taxed in Argentina only on their Argentine sourced income⁴⁹ at a tax rate of 35 percent.⁵⁰

V. OTHER ARGENTINE BUSINESS ENTITIES

A. GENERAL PARTNERSHIPS (*SOCIEDAD COLECTIVA*)

An Argentine general partnership, or *sociedad colectiva*, is an association formed by two or more individuals organized under an entity name to operate a business for profit in which the identity of the partners plays a key role.⁵¹ The rights and duties of partners are generally determined by agreement among the partners and are often set forth in a written partnership agreement.

Unless otherwise stated in the partnership agreement, general partners share equally in profits and losses, participate equally in management, have the right to refuse new partners, and may enter into contracts that bind the partnership.⁵² The internal affairs are decided by unanimous consent unless otherwise provided by agreement.⁵³ Corporations are prohibited from being partners in a partnership. Depending on the terms of the partnership agreement, the partnership's existence may end upon death, departure of any of its partners, or upon the occurrence of certain other specified events.⁵⁴

Unlike a corporation, a partnership is not considered a separate entity for most purposes. All of the partners are jointly and severally liable for partnership debts, but it is important to highlight that the partnership's liability is subsidiary. Therefore, creditors must first liquidate the partnership's assets in order to collect from partners' personal assets.⁵⁵

Under federal income tax law, the taxable income of a general partnership is computed at the partnership level and is allocated to partners according to the capital or profit-sharing agreement. Each partner is subject to income tax on his or her allocated share of taxable income; therefore, general partnerships are flow-through entities and are not sub-

47. There is no need for the branch to have a specific amount of capital with the exception of certain activities, such as banking or insurance.

48. INC. TAX. L. art. 14.

49. INC. TAX. L. arts. 1, 14.

50. INC. TAX. L. art. 69(b).

51. Commercial Companies Law art. 126.

52. Commercial Companies Law arts. 127-28.

53. Commercial Companies Law arts. 130-31.

54. Commercial Companies Law art. 90.

55. Commercial Companies Law art. 125.

ject to tax at the entity level.⁵⁶

B. *SOCIEDAD ACCIDENTAL O EN PARTICIPACIÓN*

This type of entity is similar to the German *stille gesellschaft*, the French *societe en participation*, and the Japanese *tokumei kumiai*. In Argentina, it is organized under the Commercial Companies Law Nº 19.550 and represents a type of secret or anonymous organization that is not entitled to a name. It does not need to be registered, nor is it considered a separate legal entity.⁵⁷ In other words, the *sociedad accidental o en participacion* is just a contractual relationship that cannot possess rights on its own behalf.

In the *sociedad accidental o en participación*, the entrepreneur or entrepreneurs (*socio gestor/es*) enter into contracts with the investor-partners (*socios participples*) who contribute cash or property, which then becomes the property of the entrepreneur, in exchange for a share of the profits.⁵⁸ In this sense, the entrepreneur owns all the assets, manages the business, and is personally and completely liable for all debts.⁵⁹ The investor-partners have liability limited to their contributions⁶⁰ unless they allow the entrepreneur to inform third parties of their existence, in which case their liability becomes unlimited.⁶¹

The main difference with the similar entities mentioned above (*stille gesellschaft*, *tokumei kumiai*, etc.) is that according to the Argentine Commercial Companies Law, the *sociedad accidental o en participacion* shall have a defined and temporal undertaking.⁶² In other words, it represents a type of association constituted for transitory purposes. However, this view is changing for many legal interpreters and even for federal courts, since they have admitted certain *sociedad accidental o en participacion* with far more prolonged undertakings.⁶³ In this regard, it has been said that "the real characteristic of this type of entity, is not its temporal undertaking but its anonymous nature,"⁶⁴ and the anonymous attribute should not have to be understood as "illegally secret" but as the lack of responsibility offered by the investors-partners to third parties.⁶⁵ Therefore, whether or not third parties are aware of the existence of the investor-partners is irrelevant. What is relevant is whether the entrepreneur, with the investor-partner's consent, discloses to third parties the existence of the investor-partners.⁶⁶ As stated before, if that is the case,

56. INC. TAX. L. arts. 49-50.

57. Commercial Companies Law art. 361.

58. *Id.*

59. Commercial Companies Law art. 362.

60. Commercial Companies Law art. 365.

61. Commercial Companies Law art. 363.

62. Commercial Companies Law art. 361.

63. NISSEN, *supra* note 41, at 339.

64. "Parreta, Vicenta c/Coscia, Cosme," CNCom., Sala C L.L. 339 (Sept. 18, 1978) (on file with author).

65. NISSEN, *supra* note 37, at 339.

66. *Id.*

the investor-partners have personal and unlimited liability for the organization's debts.⁶⁷

Although the Commercial Companies Law does not establish whether the entrepreneur (*socio gestor*) has to keep separate books and records of the business, federal courts have stated that they must. In this sense, it has been said that: "some method of accountability is necessary in order to show the 'day-to-day' activities of the business, not only for control, but also for bankruptcy purposes."⁶⁸ Moreover, the investor-partners will always have the right to examine the records.⁶⁹

The *sociedad accidental o en participación* does not constitute a separate entity for income tax purposes.⁷⁰ It constitutes a flow-through entity and the entrepreneur (*socio gestor*) reports all the profits or losses of the entity in his own name. He then deducts the portion of the profits allocated to the investor-partners (*socios inversores*). In essence, the *sociedad accidental o en participación* is treated as a loan for accounting purposes.

For tax reasons, a *sociedad accidental o en participación* could be an interesting choice for a foreign individual who desires to invest in and set up a mid-size business in Argentina. Under Argentine tax law, foreign individuals who perform permanent activities in Argentina are treated as Argentine residents and taxed on their worldwide income.⁷¹ The lack of performance and management of the investor-partners in the business, and even the anonymous nature of the *sociedad accidental o en participación*, make the investor-partners appear like passive investors, and, therefore, not as performing "permanent activities" in Argentina.

C. LIMITED PARTNERSHIP (*SOCIEDAD EN COMANDITA SIMPLE*)

This type of entity is organized under an entity name and personal basis, and includes one or more general partners, each of whom is personally liable for partnership debts, and one or more limited partners, each of whom is limited to the extent of their capital contributions.⁷² Except in the taxation field, this type of entity is more similar to a general partnership than it is to a corporation.⁷³ Limited partnerships have some common uses in the transportation business. The management of limited partnerships rests on general partners or people named by them, and it is

67. Commercial Companies Law art. 363.

68. "Iglesias contra Basterrechea SA Sobre Ordinario," CNCom., [Sala B] (1990) (on file with author).

69. NISSEN, *supra* note 37, at 340.

70. INC. TAX. L. art. 50.

71. INC. TAX. L. art. 119.

72. EDUARDO A. BARREIRA DELFINO, EMPRESAS, LA ORGANIZACION JURIDICA 30 (1998) (on file with author).

73. In fact, Argentinean courts have said that in case of legal gaps, the rules applicable to limited partnerships are those applicable to general partnerships instead of corporations. "Zambrano de Cima, Maria c/ Farmacia Monviso SCA," CNCom. [Sala A.] (1989) (on file with author).

governed by general partnership's rules as to how it must be exercised.⁷⁴ However, limited partners are excluded from management under the Commercial Companies Law,⁷⁵ and they are only authorized to carry out acts of opinion and control, such as the inspection of records.⁷⁶ If the limited partners violate this statute, they become personally liable for the limited partnership's debts. The rules on the internal affairs of the limited partnership are governed by those of the General Partnership.⁷⁷ In this sense, every change in the partnership's agreement, including the transferability of a partner's shares, must be decided by 100 percent of the votes by value.⁷⁸

In regard to the *sociedad colectiva's* capital, it is important to note that general partners can contribute non-monetary assets, but limited partners are only allowed to contribute monetary assets.⁷⁹

Limited partnerships are subject to taxation at the entity level and are taxed in the same manner as corporations.⁸⁰ Therefore, distributions of profits to the members are not subject to income tax, unless the dividend exceeds the after-tax accumulated taxable income of the taxpayer.⁸¹ In this case, a final withholding tax of 35 percent applies to the excess.⁸²

D. *SOCIEDAD EN COMANDITA POR ACCIONES*

With this type of entity, the Commercial Companies Law appears to combine capital and labor in one enterprise. This allows the investor-partner to limit his liability to the shares subscribed, leaving management in charge of the general partners who have unlimited liability for the debts of the *sociedad en comandita por acciones*.⁸³

Although rules of the limited partnership and the corporation are applicable,⁸⁴ the Commercial Companies Law asserts a preference for the corporation rules declaring that "corporation rules are applicable unless otherwise stated in the section."⁸⁵

Just as in limited partnerships, there are two kinds of partners in the *sociedad en comandita por acciones*: limited partners with limited liability to the extent of their capital contributions and general partners with unlimited personal liability. The main characteristic of the *sociedad en comandita por acciones* is that the capital contributed by the limited partners is represented by shares.⁸⁶ Management rests on one or more

74. Commercial Companies Law art. 163.

75. Commercial Companies Law art. 137.

76. Commercial Companies Law art. 138.

77. Commercial Companies Law art. 139.

78. Commercial Companies Law arts. 131-32, 139.

79. Commercial Companies Law arts. 35, 135.

80. INC. TAX. L. art. 69.

81. INC. TAX. L. art. 46.

82. INC. TAX. L. art. 69.

83. GARRONE & SAMMARTINO, *supra* note 27, at 295.

84. NISSEN, *supra* note 37, at 731.

85. Commercial Companies Law art. 316.

86. Commercial Companies Law art. 315.

general partners, while limited partners are prohibited from occupying managerial roles,⁸⁷ which is similar to limited partnerships. For purposes of quorum and majority vote at meetings governing internal affairs, votes will be apportioned among general partners by share value and among limited partners by stock value.⁸⁸ In every other matter concerning shareholders' meetings, corporation rules apply,⁸⁹ including the decision to transfer a general partner's shares in the entity.⁹⁰ This is unlike limited partnerships (*sociedad en comandita simple*), in which general partnership rules apply regarding the transferability of a partner's share in the entity.

The *sociedad en comandita por acciones* is subject to taxation at the entity level and, in the same manner as corporations, falls under income tax law. In addition, distributions of profits to the members are not subject to income tax,⁹¹ unless the dividend exceeds the after-tax accumulated taxable income of the taxpayer, in which case a final withholding tax of 35 percent applies to the excess.⁹²

E. SOCIEDAD CIVIL

The *sociedad civil* is a type of association organized under the Civil Code. It is similar to the Japanese *nin-I-kumiai* because it is a contractual relationship, in which two or more parties agree to carry on a joint undertaking by making a contribution to the association, with a view of sharing profits or losses.⁹³ Since the enactment of the Commercial Companies Law N° 19.950, this type of entity has lost importance in Argentina, although professional associations, like attorneys and accountants, continue to use it. The main characteristics of the *sociedad civil* can be summarized as follows:

! They have legal existence and capital separate from their members;⁹⁴

! They can be formed for an unlimited duration of time;

! The liability of partners, although unlimited, is allocated according to the number of members in equal proportions, unless otherwise stated in the agreement (in other words, creditors are not allowed to go against just one of the members for the total debt);⁹⁵

! The contributions may be in the form of cash, property, or services;⁹⁶

87. GARRONE & SAMMARTINO, *supra* note 27, at 297.

88. Commercial Companies Law art. 321.

89. DELFINO, *supra* note 72, at 68.

90. Commercial Companies Law arts. 244, 323. In this sense, article 244 requires a quorum of 60% of the shares with voting power in the first meeting and 30% of the shares of the same class in the second meeting. In both meetings, the majority required to take resolutions is 100% of the present quorum.

91. INC. TAX. L. art. 46.

92. INC. TAX. L. art. 69.

93. Cód. Civ. art. 1648-

94. Cód. Civ. arts. 39, 1703, 1712, 1714-15 (1997).

95. Cód. Civ. art. 1747 (1997).

96. Cód. Civ. art. 1649 (1997).

! Management rests on all of the members, unless otherwise stated in the contract, but each of the partners has veto power over the administration of the other, until the act becomes effective against third parties;⁹⁷

! The law applicable to this type of entity is the Civil Code, except for dissolution of the entity and all matters not expressly regulated by the Civil Code (in such cases, the Commercial Companies Law applies).⁹⁸

Contributions are presumed to be the property of the *sociedad civil*, unless stated in the agreement that they were given solely for use. Modification to the *sociedad civil*'s agreement, including transferability of a partner's shares (if allowed in the agreement), must be decided through the unanimous consent of the partners.⁹⁹ The conduct of internal affairs is decided by a majority vote of the partners.¹⁰⁰

One of the main differences of the *sociedad civil* compared to the general partnership (*sociedad colectiva*) is the liability of the members. On the one hand, in the *sociedad civil* there is no subsidiary liability; therefore, creditors of the entity are simultaneously creditors of the members,¹⁰¹ and their liability is divided into equal parts according to the number of members, unless otherwise stated in the agreement.¹⁰² On the other hand, the liability of partners in general partnerships (*sociedad colectiva*) is subsidiary, which implies that creditors should collect their debts from the company's assets, before going against a partner's assets.

The Civil Code requires this type of association to keep separate accounting records.¹⁰³ Moreover, under the Federal Income Tax Law, the taxable income of the *sociedad civil* is allocated to the partners according to the capital or profit-sharing agreement. Each partner is subject to income tax on his or her allocated share of taxable income; therefore, the *sociedad civil* is a flow-through entity and is not subject to tax at the entity level.¹⁰⁴

VI. ARGENTINE BUSINESS ENTITIES AND THE U.S. CHECK-THE-BOX RULES

The favorite type of entity selected by foreign investors in Argentina by the time of incorporating local entities, is the *sociedad anonima* or SA (corporation), and at the same time, it is the most common type of entity used by Argentine investors. On the other hand, it is not difficult to classify the *sociedad anonima* under the U.S. check-the-box rules. It is clearly an entity separate from its owners and is not a "trust under [Treas. Reg.] § 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code" (such as real estate mortgage investment con-

97. Cód. Civ. art. 1677 (1997).

98. NISSEN, *supra* note 37, at 359.

99. Cód. Civ. arts. 167-75 (1997).

100. NISSEN, *supra* note 37, at 359.

101. Cód. Civ. art. 1713 (1997).

102. Cód. Civ. art. 1747 (1997).

103. Cód. Civ. art. 1696 (1997).

104. INC. TAX. L. arts. 49-50.

duit (REMIC) or a qualified settlement fund (QSF)).¹⁰⁵ Therefore, it is a business entity under the final regulations. Moreover, the *sociedad anonima* is the only Argentine entity listed on the list of foreign entities automatically classified as a corporation.¹⁰⁶ As a result, the *sociedad anonima* is not an eligible entity entitled to elect its classification.

The SRL (LLC) seems to be an entity separate from its owners and does not appear to be a “trust under [Treas. Reg.] § 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code” (such as a REMIC or a QSF).¹⁰⁷ As a result, the SRL appears to be a business entity under the final regulations not listed in the list of foreign entities automatically classified as a corporation.¹⁰⁸ Hence, the SRL is an eligible entity entitled to choose its classification under the regulations, but considering that the SRL cannot have less than two members or more than fifty members,¹⁰⁹ it can only elect to be taxed as a partnership or as a corporation. On the other hand, the limited liability of the SRL’s partners should determine a corporation’s status under the default rule.

The *sociedad colectiva* (general partnership) seems to be a separate entity and does not appear to be a “trust under [Treas. Reg.] § 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code.”¹¹⁰ Moreover, the *sociedad colectiva* is not on the list of per se corporations, and consequently, it is a business entity eligible to elect its classification under the check-the-box regulations. Again, the fact that the *sociedad colectiva* must have at least two members makes corporation or partnership status the only choices available. The default rule appears to be straightforward. Because the members of the *sociedad colectiva* have unlimited liability, the *sociedad colectiva* should be treated as a partnership.

Despite some differences between the *sociedad en comandita simple* (limited partnership) and the *sociedad en comandita por acciones* (where the capital is composed primarily by shares), for purposes of this article, they will be treated together under the check-the-box rules because of their similar liability and tax regime. They appear to be separate entities and do not seem to be a “trust under [Treas. Reg.] § 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code.”¹¹¹ Furthermore, neither is listed on the list of foreign entities automatically classified as corporations, and therefore, they are business entities entitled to choose their classification. Both the *sociedad en comandita simple* and the *sociedad en comandita por acciones* must have at least two members; consequently, they can select either association or partnership status. However, under the default rule, the fact that they have at least one

105. Treas. Reg. § 301.7701-2(a) (as amended in 1996).

106. Treas. Reg. § 301.7701-2(b)(8)(i).

107. Treas. Reg. § 301.7701-2(a).

108. Treas. Reg. § 301.7701-2(b)(8)(i).

109. *Id.*

110. Treas. Reg. § 301.7701-2(a).

111. *Id.*

member with unlimited liability suggests that they should be treated as partnerships.

The Argentine branch of a U.S. entity seems to be treated completely different under U.S. tax laws. As previously described, in Argentina a branch of a foreign entity is treated as a separate entity from its head office for accounting and tax purposes, although the head office remains liable for all of the branch's debts. However, even if "the organization is recognized as an entity under local [U.S.] law," it will not necessarily be treated as "a separate entity for federal tax purposes."¹¹² Under U.S. tax law, the Argentine branch does not appear to be a separate entity because (1) the head office is always liable for all of the branch's debts, suggesting that both are the same party¹¹³ and (2) it does not seem to be a co-ownership of property, a contractual agreement, or a joint venture in which "participants carry on a trade, business, financial operation, or venture and divide the profits [from it]."¹¹⁴ In addition, a branch does not look to be a trust, leading to the conclusion that it could be considered as a "nothing"¹¹⁵ or a disregarded organization,¹¹⁶ falling into the first of the three major categories mentioned above ("nothing," trust, or business entity). Under the default rule, a foreign entity is "[d]isregarded as an entity separate from its owner if it has a single owner that does not have limited liability."¹¹⁷ As stated before, the head office (owner of the Argentine branch) is completely liable for a branch's debts. Finally, it is not clear whether an organization like a branch, could select to be taxed as a corporation. It would be helpful if the Treasury provided more guidance in this area.¹¹⁸

112. Treas. Reg. § 301.7701-1(a)(1), (3).

113. Although the regulations do not contain any guidance on when a business enterprise owned by a single member will constitute a separate entity so as to enable the owner to elect to have it treated as an association or disregarded as a tax "nothing," the preamble of the proposed regulations state that the regulations would permit a business entity with a single owner that is not required to be "classified as a corporation to elect to be classified as an association or to have the organization disregarded as an entity separate from its owner." Simplification of Entity Classification Rules, 61 Fed. Reg. 244, 585 (Dec. 18, 1996) (to be codified at 26 C.F.R. pt. 301).

114. "For example, a separate [undertaking] exists for federal tax purposes if co-owners of an apartment building lease space and in addition provide services to the occupants either directly or through an agent. Nevertheless, a joint undertaking merely to share expenses does not create a separate entity for federal tax purposes." Treas. Reg. § 301.7701-1(a)(2).

115. Treas. Reg. § 301.7701-1(a)(1)-(2).

116. "Certain organizations that have a single owner can choose to be recognized or disregarded as entities separate from their owners." Treas. Reg. § 301.7701-1(a)(4)

117. Treas. Reg. § 301.7707-3 (b)(2)(C).

118. Treas. Reg. § 301.7701-1(a)(4). The preamble of the proposed regulations state that many commentators requested guidance concerning the classification of an unincorporated business entity with a single owner. The proposed regulations permit a business entity with a single owner that is not required to be classified as a corporation to elect to be "classified as an association or to have the organization disregarded as an entity separate from its owner." Simplification of Entity Classification Rules, 61 Fed. Reg. 244, 585 (Dec. 18, 1996) (to be codified at 26 C.F.R. pt. 301).

The *sociedad civil* seems to be a separate entity because it is clearly a contractual relationship in which participants agree to carry on a business and divide profits, and it does not seem to be a “trust under [Treas. Reg.] § 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code.”¹¹⁹ On the other hand, the *sociedad civil* is not listed on the list of foreign entities automatically classified as a corporation.¹²⁰ Therefore, taking into account that the *sociedad civil* must have at least two members,¹²¹ it appears to be an entity eligible to select association or partnership status. Pursuant to the default rule, creditors of the entity are, at the same time, creditors of the members¹²² (generally with liability divided equally),¹²³ which suggests that the *sociedad civil* should be treated as a partnership.

A. SOCIEDAD ACCIDENTAL O EN PARTICIPACIÓN

The *sociedad accidental o en participación* deserves special attention because there is no comparable business structure in the United States, making it difficult to classify within the U.S. tax system. As stated before, the *sociedad accidental o en participación* is not a separate entity for legal and tax purposes. It constitutes a contractual relationship in which the entrepreneur (*socio gestor*) owns all of the organization’s assets, conducts the business, and has unlimited liability for the organization’s debts.¹²⁴ Investor-partners have no contractual relationship. Furthermore, investor-partners are not liable for the organization’s debts, unless one or more investor-partners allows the entrepreneur to disclose his or their participation to third parties, in which case such investor-partner(s) becomes fully liable for the organization’s debts.¹²⁵

Under the U.S. check-the-box rules, it would seem that there are two pertinent viewpoints to take into account: (1) the investor-partner’s perspective and (2) the entrepreneur’s perspective.

1. The Investor-Partner Perspective

As previously stated, each investor enters into a separate (and probably different) contract with the entrepreneur;¹²⁶ moreover, it might be possible that each investor ignores the existence of the rest of the group (if there is actually a group). Therefore, it seems that each contract between an investor and an entrepreneur (which appears to be a “contractual agreement . . . [in which] participants carry on a trade, business,

119. Treas. Reg. § 301.7701-2(a).

120. Treas. Reg. § 301.7701-2(b)(8)(i).

121. Cód. Civ. art. 1648 (1997).

122. Cód. Civ. art. 1713 (1997).

123. Cód. Civ. art. 1747 (1997).

124. *Id.*

125. *Id.*

126. Hanna, *supra* note 5, at 96.

financial operation, or venture and divide the profits [from it]"¹²⁷) implies a separate entity under the U.S. check-the-box rules.

Assuming that each contract between an investor and an entrepreneur of the *sociedad accidental o en participación* constitutes a separate entity (notwithstanding the existence of more investors), it would be a separate entity composed of two members and, therefore, entitled to elect tax treatment as either a corporation or a partnership (given that it does not seem to be a "trust under [Treas. Reg.] & 301.7701-4 or otherwise subject to special treatment under the [IRC],"¹²⁸ and it is not listed on the list of foreign entities automatically classified as corporations). Regarding the default rule, since the entrepreneur and in some cases the investor-partners have unlimited liability, the *sociedad accidental o en participación* should be treated as a partnership.

2. The Entrepreneur's Perspective

Assuming that the entrepreneur is a U.S. citizen or U.S. entity, which is operating under its own name or through a representative, the situation could be different. Under this perspective, it would seem that the U.S. entrepreneur, a partner of the *sociedad accidental o en participación*, may consider the business as a single-owner organization that can elect to be recognized or disregarded as an entity separate from its owner.¹²⁹ In this situation, taking into account that (1) the entrepreneur is the only person with unlimited liability, (2) he exclusively conducts the business on his own behalf, (3) profits and losses do not flow through the investors, and (4) the *sociedad accidental o en participación* is not a separate entity in Argentina for legal and tax purposes, the investors could be seen simply as lenders of the entrepreneur for tax planning purposes and, therefore, not as members of any kind of association.¹³⁰ Accordingly, for U.S. tax purposes, the *sociedad accidental o en participación* may be treated as having a single owner, similar in many respects to a branch (division) or sole proprietorship, depending on whether the entrepreneur is a U.S. corporation or an individual. If it is viewed as a branch or sole proprietorship, the issue arises as to whether the *sociedad accidental o en participación* can check-the-box and elect association status.¹³¹ With respect to the default rule and assuming that the entrepreneur is the only member under the check-the-box rules, the *sociedad accidental o en par-*

127. For example, a separate undertaking exists for federal tax directly or through an agent. "Nevertheless, a joint undertaking merely to share expenses does not create a separate entity for federal tax purposes." Treas. Reg. § 301.7701-1(a)(2).

128. Treas. Reg. § 301.7701-2(a).

129. See Simplification of Entity Classification Rules, *supra* note 118, at 585.

130. Hanna, *supra* note 5, at 97 (regarding the *tokumei kumiai*, which is similar to the *sociedad accidental o en participación*). It may be possible that the issue of whether the investors are members of the *tokumei kumiai* or simply creditors will have to be decided on a case-by-case basis. The relationship between entrepreneur and investors varies from one *tokumei kumiai* to another and may actually vary within a single *tokumei kumiai*.

131. Hanna, *supra* note 5, at 95.

ticipación could be disregarded as an entity separate from its owner because of the unlimited liability of the entrepreneur.¹³² Finally, under Argentine income tax law, a U.S. entrepreneur that performs permanent activities (if it is a person and not a corporation) through the *sociedad accidental o en participacion* is considered to be an Argentine resident and, therefore, will be subject to taxation on a worldwide income basis. Thus, the Treasury should provide some guidance on the issue regarding the *sociedad accidental o en participacion* since it is not defined under the current regulations.

VII. FINAL CONCLUSIONS

The combination of limited liability and flexibility for purposes of the U.S. check-the-box rules makes the Argentine SRL a valuable choice compared with the SA because the check-the-box rules automatically classify the SA as a corporation. However, the SA is still the most common and prestigious type of entity used by foreign investors because of the characteristics depicted above.

In regard to the *sociedad accidental o en participación*, it is clear that it would be helpful if the Treasury provided some guidance. Despite the fact that the *sociedad accidental o en participación* is rarely used in Argentina, it could be an interesting choice for U.S. investors under the U.S. check-the-box rules because of the limited liability it provides to investors. Additionally, it provides entrepreneurs the possibility to be considered as a branch or sole proprietorship and to eventually check-the-box and elect association status. However, it is important to remember that in Argentina the *sociedad accidental o en participación* is just a contractual relationship and not a separate entity for legal and tax purposes. Therefore, this type of entity is confined to small and mid-size investments.

Finally, it is important to note that under Argentine income tax law, foreign individuals who perform permanent activities in the country are treated as Argentine residents.¹³³ Argentine residents are taxed on their worldwide income. However, the fact that in the *sociedad accidental o en participación* the permanent activities are performed in the entrepreneur's own name and the investor-partner is just an investor makes the *sociedad accidental o en participación* an interesting choice for foreign individuals who want to invest in or set up a business in Argentina.

132. Treas. Reg. § 301.7707-3(b)(2)(C).

133. INC. TAX. L. art. 119.

