

## Laws & Regulations

### THE MODE OF TAXATION OF BRANCHES AND REPRESENTATIVE OFFICES OF FOREIGN COMPANIES IN IRAN

The following Circular Letter No.232/1623/18921 has just been issued by Mr. A. A. Arab'mazar, the Head of Taxation Affairs Organization on the mode of taxation of foreign companies:

In order to bring about uniformity in investigation of the tax files of the branches and representative offices of foreign companies in Iran, tax assessors shall be required to take the following points into consideration:

1. Representative offices and branches of foreign companies may be registered in Iran in order to carry out anyone or more of the following activities

in accordance with the Law on Registration of Foreign Companies :

1.1 Supply of after sales services in respect of the commodities sold or services provided by a foreign company.

1.2 Carrying out the executive works required to be rendered under a contract concluded with the foreign company concerned and Iranian entities.

1.3 To investigate and prepare grounds for investment in Iran by the foreign company concerned.

1.4 Cooperation with Iranian technical and engineering

companies.

1.5 Promotion of non-oil exports.

1.6 Supply of technical and engineering services and transfer of technology.

1.7 To carry out the activities authorized by government organizations in charge of such authorizations such as the supply of services in the fields of transportation, insurance, goods surveillance, marketing, etc.

2. Iranian natural persons and legal entities (companies limited by shares, limited liability companies, firms, etc.) representing foreign companies

in Iran shall also be subject to the provisions of this Circular.

3. It should be noted that the branches and representative offices of foreign companies, according to the provisions of Article 1 of the Executive Bylaws of the Law on Registration of Branches and Representative Offices of Foreign Companies, approved by the Council of Ministers on March 31, 1999, may operate in Iran only in respect of the activities enumerated in Clause 1 above and registration of a branch or representative office may be possible only in respect of the said activities. Therefore, tax assessors are required to check the validity of the relevant feasibility report or the permission given to a foreign company in order to continue its activities in Iran, at the time of examination of tax returns in accordance with the requirements of Articles 3 and 10 of the said Executive By-Laws.

4. In implementation of Article 8 of the Executive By-Laws of the Law on Registration of Branches and Representative Offices of Foreign Companies as well as Sub-clause e of Article 2 of the Executive By-Laws of Note 4 of the Law on Utilization of Services of Official Accountants, the tax assessors shall be under the obligation to ask for audited financial statements of the branches and representative offices of foreign companies when asking for submission of their accounts books and vouchers as provided in Sub-clause 2 of Article 97 of

the Direct Taxation Act.

5. Considering that a condition and requirement for the registration of a branch or representative office of a foreign company, as provided in Article 5 of the Executive By-Laws of the Law on Registration of Foreign Companies, is the grant of a permission to be given in this regard by a government organization, the tax assessors are, therefore, required to check the said permission at the time of checking the accounts books and vouchers of the branch or representative office concerned.

6. According to the provisions of the above said Executive By-Laws, branches of foreign companies are required to submit, every year, the Annual Report of the head office of the company including its financial reports audited and confirmed by independent auditors in the country where the head office of the branch office is located, to the authorities in Iran who issued the relevant permit. Therefore, tax assessors shall be under the obligation to communicate with the sponsoring organizations and to obtain the required information.

7. Despite the tax exemption provided under Note 3 of Article 107 of the Direct Taxation Act for the branches and representative offices of foreign companies and banks that are engaged in marketing and collecting economic information for their head offices without having the right of entering into any transaction in Iran and receive money from their head offices to

cover their expenses in Iran, the following points must be taken into consideration in respect of the activities of this type of companies in Iran:

7.1 Some branches and representative offices of foreign companies in Iran, in addition to marketing and collecting information for the use of their own head offices, also collect information and carry out marketing activities for other foreign entities. In such case, the works carried out for the benefit of other foreign entities shall be regarded as taxable activities.

7.2 Some branches and representative offices of foreign companies, in addition to carrying out marketing and market research activities, are also engaged in after sales services. In such case, the said after sales services do not fall in the category described under Note 3 of Article 107 above and any such branch of a foreign company, in addition to the obligation for payment of the tax accruing on the said after sales services, shall also be subject to tax on commission it will be due to receive.

7.3 Some branches and representative offices of foreign companies, despite the notice of their incorporation issued by the Companies Registry, that clearly and distinctly provides that they are not authorized to become engaged in any profit making activities, issue proforma invoices and sign contracts on behalf of their head offices with clients in Iran. In such case, the said branches and

representative offices may not benefit from the tax exemption provided under Note 3, Article 107 above and shall be subject to taxation and their income must be investigated, identified and assessed according to the rules of international trade.

8. Tax assessors, in implementation of Note 3 of Article 107 of the Direct Taxation Act, shall be under the obligation to become certain about the manner and nature of activities of foreign companies in Iran through investigation of the documents and vouchers in the company and collecting the required data and information. Should, as a result of such investigation, it will become known that the head office of the company is selling goods or services (direct sales), the status of the branch office shall not be regarded as before and the said branch office will be considered to have entered into profit making activities or else the said branch office shall be under the obligation to introduce another natural person or legal entity that is acting as the representative of direct sales.

9. All works pertaining to representatives, in accordance with the norms of international trade, will be carried out under contacts. Taxpayers, in implementation of tax laws, shall be under the obligation to provide their representation agreement, related to their documents and vouchers, to the tax office.

10. In accordance with the format international contracts

(DECD), as well as the laws on avoiding double taxation, concluded by and between Iran and other countries, in cases where an entity of a contracting state shall, directly or indirectly, participate in the administration, control or the capital of an entity of the other contracting state, or in cases where the same entities or individuals shall, directly or indirectly, participate in the administration, control or the capital of the entity of the other contracting state, and both entities shall be related to each other as regards their trading or fiscal relations under any conditions (whether agreed by, or forced upon them) which conditions shall be different from the conditions in force between independent entities (Arms length principle/third party comparison basis), the profits that could be earned by anyone of the said entities if the said conditions did not exist, and such profits were not earned due to the existence of the said conditions, can be regarded and accounted as the profits of that entity and made subject to taxation.

11. In identifying incomes and assessment of profits, legal principles and business criteria, under normal conditions, must be complied with. Therefore, tax assessors, while investigating a tax case, must become certain of the nature of the relations between a branch or representative office of a foreign company in Iran with its head office with due regard to the documents and evidences that have come in hands of the tax assessor and make certain,

in one way or another, of the validity or falsehood of the representation agreements and the declared incomes. With due consideration of the international norms of the activities of commission agents, all cost plus, lumpsum commission or fee against services agreements may be acceptable only in case such agreements shall have homogeneous and logical basis similar with the agreements concluded by and between independent entities in which a commission or fee is being normally paid in the form of a percentage of the final invoice of the supplier. The basis of calculation of the income, in such cases, shall be the invoice of the foreign supplier that will be paid through letters of credit in cash, bills of exchange, cash direct through transfer of funds or other methods. Therefore, if the declared income, with due consideration of the normal rates charged by commission agents being independent entities or individuals, shall not be acceptable, then the amount of the letters of credit and its equivalent in rials registered with bank, must be used as the basis for fixing the commission income.

12. As provided in Sub-clause 16 of Article 20 of the Regulation on the Manner of Making Entries in Ledgers, the registration of false expenses and incomes in the ledgers, provided that such falsehood shall be established, shall be the cause of rejection of the accounts books. Therefore, tax assessors are expected to verify the agreements submitted to them

and compare the said agreements with other commission agency agreements concluded under normal conditions in accordance with the rules of international trade and prevailing market conditions and must report the false instances to the three-member panel set forth in Sub-clause 3 of Article 97 of the Direct Taxation Act.

13. According to Article 8 of the Executive By-Laws of the Law on Registration of Branches and Representative Offices of Foreign Companies as well as Sub-clause e of Article 2 of the Executive By-Laws of Note 4 of the Law on Expert and Professional Services of Official Accountants, the branches and representative offices of foreign companies in Iran, are under the obligation to utilize the services of official accountants being members of the Society of Official Accountants to act as auditors of their companies. Therefore, the financial statements of the above companies duly audited by official accountants must be examined by tax assessors and the said audited statements must be used as the basis of examination of tax returns.

14. Considering that the firms of auditors and fiscal services are in charge of the accounting and book-keeping works of most of the branches and representative offices of foreign companies, tax assessors must note that according to the principle of independence in auditing, the audit report of the said companies must be drawn up by yet another firm of auditors that will be

independent of that in charge of accounts and book-keeping of the company. Therefore, any audit report made and drawn up by the firm of accountants that is in charge of book-keeping of the company shall not be valid and acceptable.

15. The official accountants in charge of auditing the accounts of branches and representative offices of foreign companies in Iran shall be under the obligation to express explicit opinion regarding the identification of incomes and expenses and correctness of the declared incomes including the commission, fee or discount granted to the company and the normal state of commercial affairs of the company and shall fill in the attached form.

Action shall be taken in the following manner in respect of the branches and representative offices engaged in the sale of commodities, equipment, or supply of services in Iran:

15.1 The branches and representative offices supplying goods, equipment or services directly to Iran shall be taxed on the basis of the volume of their sale or their income earned through supply of services according to the regulations of the Direct Taxation Act and other applicable regulations.

15.2 As regards the branches and representative offices having a contract with their head office according to which the sales shall be carried out by the head office and the branch or representative office only records the commission of the

sales or the discounts allowed on the sale in its accounts books in Iran, shall not be authorized to record the said commissions or discounts less than the normal commissions or discounts. Therefore, in cases where the said branches or representative offices fail to record their actual income like an independent entity in their account books, or declare a lesser income by presenting superficial agreements, the tax assessors shall acquire reasonable and creditable documents and evidences and shall carefully compare the said agreements with those of other foreign representative offices and shall assess and fix the income of the above said taxpayers, accordingly.

16. Iranian natural persons and legal entities being the exclusive agents of foreign companies that are engaged in transactions pertaining to foreign commodities and rendering services in this regard in Iran, shall be bound to declare their income earned through the sale of foreign goods and services, regardless of whether such income will be earned in cash, by transfer of money or in non-pecuniary form by goods or parts.

17. Other natural persons and legal entities engaged in representing foreign companies in Iran (sale of commodities, supply of technical services, surveillance, etc.) shall be subject to these regulations as regards the examination of their accounts books.

Ali Akbar Arabmazar (Sgd.)