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Tax Update

Treasury Issues Long-Awaited Guidance Regarding Transfer Pricing Studies

Sections 1033.17(a)(16) and 1033.17(a)(17) of Puerto Rico Internal Revenue Code of 2011, as amended (“Code”) disallow deductions for 51% of the expenses incurred by a taxpayer and paid or to be paid to: (i) a related person not engaged in a trade or business in Puerto Rico, if such expenses are attributable to the conduct of a trade or business in Puerto Rico and not subject to tax or withholding at source under the Code in the taxable year in which they were incurred or paid, or (ii) a home office located outside of Puerto Rico, by a foreign corporation engaged in trade or business in Puerto Rico through a branch, when computing the net taxable income (“Disallowance Rule”).

Act 257-2018 amended the Code to provide that, for taxable years commenced after December 31, 2018, taxpayers may avoid the application of the Disallowance Rule by filing, with their income tax return, a transfer pricing study prepared pursuant to Section 482 of the United States Internal Revenue Code of 1986, as amended, which includes the Puerto Rico operations (“TPS”). Statutory language introduced as part of such amendment indicates that the Secretary of the Treasury (“Secretary”) shall issue regulations, circular letters or other administrative pronouncements regarding the implementation of this requirement. The Puerto Rico Department of the Treasury (“Department”) has issued [Administrative Determination 21-05](#) (“AD 21-05”) addressing matters related to such implementation.

Pursuant to AD 21-05, the Disallowance Rule will not apply when the relevant deduction is based on a TPS that is available at the time of filing of the corresponding income tax return. Such TPS must be prepared pursuant to the provisions of Sections 1033.17(a)(16) and 1033.17(a)(17) of the Code, as applicable, in harmony with Section 1040.09 of the Code, Section 482 of the United States Internal Revenue Code and Sections 1.482-2 through 1.482-9 of the regulations issued thereunder (“Federal Regulations”). To implement the foregoing, the Department has approved Form SC 6175, [Certification of Compliance with Sections 1033.17\(a\)\(16\) and \(17\) of the Puerto Rico Internal Revenue Code of 2011, as Amended](#) (“Certification”). The Certification must be signed under penalties of perjury by the same person who signs the income tax return.

The Department has further determined that a taxpayer may reasonably rely on a TPS certified in prior years provided the facts and circumstances for such taxpayer and the relevant transactions in the corresponding taxable year have not substantially changed from the time when the TPS was certified. If such a change were to materialize, the taxpayer must update the TPS pursuant to the Federal Regulations, so that the results represent the best method to reasonable establish that the transactions were undertaken at arm’s length with the information available at the date of filing of the return.



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AD 21-05 also references Section 6030.03 of the Code which imposes additions to the tax in certain cases such as a deficiency due to negligence or intentional disregard of the applicable rules and regulations and the substantial understatement of income taxes. The Department indicates that a TPS prepared in compliance with the criteria described above, reduces the risk of exposure to the additions to the tax imposed by Section 6030.03 of the Code, provided the TPS is available at the time of filing of the return and the taxpayer has issued the Certification. Nonetheless, the Secretary may reject such studies he or she believes do not comply with said criteria.

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