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Tax Update

Treasury issues Guidance with respect to the Alternative Minimum Tax Computation in light of Wal-Mart's First Circuit Court of Appeals Decision

On September 30, 2016, the Puerto Rico Treasury Department ("Treasury") issued Administrative Determination No. 16-11 ("AD 16-11") in response to the judicial repeal of various alternative minimum tax ("AMT") components.

Background

Corporations are subject to the AMT in the amount of the excess, if any, of the tentative minimum tax ("TMT") for the taxable year over the regular tax for such year.

With the introduction of the Puerto Rico Internal Revenue Code of 2011, as amended ("Code"), the AMT included a TMT computation that considered a charge based on the value of personal property purchased from a related party or transferred to a Puerto Rico branch from its "home office" ("Property Component"). Such charge could originally be waived and subsequently the applicable rate reduced, if the taxpayer was able to show to the satisfaction of the Secretary of the Treasury ("Secretary") that the price paid by the taxpayer was equal or substantially similar to, or less than, the price at which the related party sold the property to an unrelated party. Thus, the provision was commonly viewed as a transfer pricing control measure.

Act No. 40-2013 further increased the AMT by adding 20% of payments to a related party and/or 20% of costs allocated from a "home office" to the Puerto Rico branch ("Related-Party Charges"), as a component of the TMT for purposes of the determination of the AMT ("Related-Party Charges Component"). This provision only required that the Related Party Charges were attributable to a Puerto Rico business and not subject to Puerto Rico income tax in the taxable year in which they are paid or incurred. The Secretary was authorized to evaluate, at the request of the taxpayer, the nature of the expenses or costs paid to a related person or office in order to determine whether any of such expenses or costs could be excluded from the Related Party Component. Criteria for such waiver disregarded transfer pricing concerns.

Act No. 72-2015 ("Act 72") again modified the TMT for purposes of the determination of the AMT. As amended for taxable years commenced after December 31, 2014, the TMT was the greater of:

- 30% of the amount by which the alternative minimum net income for the taxable year exceeds the exempt amount, reduced by the alternative minimum foreign tax credit for the taxable year; or
- The sum of:



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- the Related-Party Charges Component; and
- the Property Component, computed at a rate which varies depending on the amount of the taxpayer’s gross sales (see table below for generally applicable rates), times the value of personal property purchased from a related party or transferred to a Puerto Rico branch from its “home office.”

Gross Sales	Applicable Rate
\$10M ≤ but < \$500M	2.5%
\$500M ≤ but < \$1.5B	3.0%
\$1.5B ≤ but < \$2B	3.5%
\$2B ≤ but < \$2.75B	4.0%
≤ \$2.75B	6.5%

Act 72 also limited the waiver that can be requested to exclude Related-Party Charges from the 20% TMT computation to 60% of such charges and eliminated the waiver previously available in connection with the Property Component.

On March 28, 2016, in Wal-Mart Puerto Rico, Inc. v. Zaragoza-Gómez, Civil No. 3:15-CV-03018 (JAF), the U.S. District Court for the District of Puerto Rico (“District Court”) held that the Related-Party Charges Component and the Property Component (“Unenforceable AMT Components”) discriminated against interstate commerce.

Persons contesting a tax are generally required to pay such tax and then request a refund to the Secretary. Further, federal courts are generally deprived of jurisdiction to enjoin the collection of taxes in Puerto Rico under the Butler Act. Nonetheless, in Wal-Mart, the District Court found that as an exception, the Butler Act allows injunctions when there are no plain, speedy and efficient remedies in the local forums. For reasons covered in detail in the 109-page opinion, the District Court found it had subject-matter jurisdiction based on the fact the tax-refund procedure to recover payments of the Unenforceable AMT Components did not provide the plaintiff a plain, speedy and efficient remedy given Puerto Rico’s fiscal circumstances.

Having jurisdiction over the matter, the District Court held that the Unenforceable AMT Components violated the dormant Commerce Clause, as well as the Equal Protection Clause and the Federal Relations Act. For such reason, the District Court ordered the Secretary to immediately stop all levying, collection, and enforcement of the AMT against Wal-Mart Puerto Rico, Inc.

On August 4, 2016, the US First Circuit Court of Appeals (“Appeals Court”) confirmed the District Court’s decision, and ruled that the Unenforceable AMT Components violate the dormant Commerce Clause.

AD 16-11 Determinations

In AD 16-11, Treasury determines that no taxpayer subject to the AMT will have to compute the Unenforceable AMT Components for taxable years commenced after January 1, 2015 (“2015 Taxable Year”). Therefore, for the 2015 Taxable Year and thereafter the TMT will be determined by calculating 30% of the amount by which the alternative minimum net income for the taxable year exceeds the exempt amount, reduced by the alternative minimum foreign tax credit for the taxable year.

Although Treasury has determined that no taxpayer subject to the AMT will have to compute the Unenforceable AMT Components effective for taxable years commenced after January 1, 2015, the fact is that the court's invalidation in the Wal-Mart case is not limited to a specific period. As a result, taxpayers must consider whether to challenge Treasury's determination by amending returns related to prior periods during which the Property Component and the Related-Party Charges Component were in effect, albeit full waivers were available with respect to both components for taxable years commenced on or before December 31, 2014.

Estimated Tax for 2016 Taxable Year

Taxpayers subject to the AMT with estimated tax installments for taxable years commenced after January 1, 2016 ("2016 Taxable Year") which are not yet due, will not have to consider the Unenforceable AMT Components when computing their estimated tax liability. Any portion of estimated tax payments already made for the 2016 Taxable Year which is attributable to the Unenforceable AMT Components may be completely applied against the taxpayer's income tax for such year.

Taxpayers that have deposited estimated taxes for the 2016 Taxable Year in excess of what their estimated tax liability would be without considering the Unenforceable AMT Components will not be required to pay the remaining estimated tax installments for such year.

AMT calculated based on the TMT for 2015 Taxable Year

Taxpayers subject to the AMT for the 2015 Taxable Year will be entitled to determine the AMT for said year without considering the Unenforceable AMT Components. If the amount of AMT paid by a taxpayer for the 2015 Taxable Year is in excess of what such amount would be without considering the Unenforceable AMT Components, such taxpayer will be entitled to a credit for the amount paid in excess ("AMT Credit") for said taxable year. Please note that the AMT Credit is not refundable.

Taxpayers eligible for the AMT Credit may opt to do one of the following:

- (1) Use the AMT Credit as a credit against AMT due for the 2016 Taxable Year and subsequent taxable years subject to the limitations imposed by the Code in connection with AMT credits; or
- (2) Use the AMT Credit as an excess payment creditable against estimated taxes for the 2016 Taxable Year.

Those taxpayer who choose to use the AMT Credit as a credit against AMT due for the 2016 Taxable Year and subsequent taxable years, must amend the income tax return filed for the 2015 Taxable Year and include a newly issued Treasury Form 483.3, "Process Form Schedule A Corporation – Part V Taxable Year 2015" ("Form"). The Form is available in www.hacienda.pr.gov, under *Returns, Forms and Schedules*.

Taxpayers who have not yet filed their income tax return for the 2015 Taxable Year and who would have been subject to the Unenforceable AMT Components, must also include the Form when filing such return.

51% Disallowance of Related-Party Charges

In addition to the Related-Party Charges Component, effective for taxable years

commenced after December 31, 2012, Section 1033.17(a)(17) of the Code disallows, for regular income tax purposes, the deduction of 51% of the expenses incurred by a taxpayer and paid or to be paid to a related person not engaged in trade or business in Puerto Rico, if such expenses are attributable to the conduct of a trade or business in Puerto Rico and are not subject to income tax or withholding at source under the Code in the taxable year in which incurred or paid. The same applies to charges to a home office located outside of Puerto Rico, by a foreign corporation engaged in trade or business in Puerto Rico through a branch. The language of Section 1033.17(a)(17) of the Code is almost identical to the language of the Related-Party Charges Component in the Unenforceable AMT Components.

In AD 16-11, Treasury determines that because the Appeals Court decision only addresses the AMT provisions, it will continue to enforce the 51% deduction disallowance of Related-Party Charges for regular income tax purposes. Again, taxpayers would have to individually determine whether to challenge Treasury's determination by amending returns related to prior periods.

You may access AD 16-11 (in Spanish) [here](#).

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