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TAX NEWSLETTER

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NEW PUBLICATIONS ISSUED BY THE PR TREASURY DEPARTMENT

New Guidelines Regarding Calculation of Alternative Minimum Tax by Corporations

On March 28, 2016, the United States District Court for the District of Puerto Rico issued an order and opinion in the case Wal-Mart Puerto Rico Inc. v. Juan Z. Zaragoza Gómez, Civil No. 3:15-cv-03018 (“Walmart Case”), where it declared invalid one of the components of the Alternative Minimum Tax (“AMT”) calculation, more specifically Section 1022.03(b)(2) and (d) of the Puerto Rico Internal Revenue Code of 2011, as amended, (the “PR Code”). On August 24, 2016, the Court of Appeals of the United States for the First Circuit confirmed the opinion of the United States District Court for the District of Puerto Rico in the Walmart Case.

As a result of the holding of the Walmart case, the Puerto Rico Department of Treasury (“Treasury”) issued on September 30, 2016 Administrative Determination No. 16-11 to: (i) clarify the applicability of the AMT for taxable year 2016 and (ii) establish the procedure to claim as a credit the taxes paid in excess, if any, during the taxable year 2015.

AMT for taxable year 2016

The Walmart Case specifically declared invalid the second component of the AMT consisting of the sum of:

- a) 20% of the expenses incurred or paid to related parties and or the expenses allocated from a home office to a branch located in Puerto Rico if such payments were not subject to tax in Puerto Rico during the tax year (“Intercompany Expense Allocation”); and
- b) The amount that arises by applying: (i) the applicable percentage of the purchases of tangible personal property from a related person and (ii) the applicable percentage to the transfer of tangible personal property from

a home office to a branch located in Puerto Rico (“Affiliated Company Purchases”).

Due to the invalidation of the AMT’s second component, taxpayers will not have to calculate the sum of the Intercompany Expense Allocation and the Affiliated Company Purchases (jointly denominated as “Invalid AMT Component”) when determining the AMT for taxable year 2016. Thus, for taxable years commencing on and after January 1, 2016, taxpayers subject to AMT must determine the minimum tentative tax calculating only 30% of the amount for which the alternative minimum net income exceeds the exempt amount, reduced by the alternative minimum credit for foreign taxes paid for such year. Accordingly, Schedule A-“Alternative Minimum Tax” of the 2016 Corporate Income Tax Return will be modified and will not be allowed to be used for prior taxable years.

Estimated Payments for taxable year 2016

Taxpayers subject to AMT whose estimated tax installments are not yet due for taxable year 2016, will not have to include the Invalid AMT Component when calculating the estimated tax. On the other hand, any portion of the estimated tax installments which has been paid for taxable year 2016 and correspond to the Invalid AMT Component may be applied towards the taxpayer’s income tax for that year.

AMT for taxable year 2015

Treasury has determined that taxpayers, who were subject to the Invalid AMT Component in 2015, have the right to recalculate the AMT without taking into consideration the Invalid AMT Component. If the AMT amount calculated in the original 2015 tax return is greater than the revised AMT amount, the taxpayer will have a credit for the amount paid in excess for that year.

Any taxpayer with a credit for the AMT amount paid in excess can do one of the following:

- 1) Use the excess as a credit against the AMT of the following years, subject to the limits imposed by the PR Code or
- 2) Use the excess as a payment in excess creditable towards the 2016 estimated tax.

Taxpayers that choose the second alternative must file an Amended Income Tax Return for taxable year 2015. Such return must be filed with Form 483.3 "*Corporation Schedule A Transmittal Form- Part V Taxable Year 2015*" properly completed and signed by a corporate official, and, when applicable, by the tax return specialist who prepared the amended return.

The amount paid in excess cannot be claimed as a refund. It can only be claimed as a credit for payment in excess of prior years in the Income Tax Return corresponding to taxable year 2016 or subsequent years, until the excess is exhausted.

On the other hand, those taxpayers whose 2015 PR Income Tax Return has not been filed yet and which, prior to the holding in the Walmart case, were subject to the calculation of the second component of the AMT, must file such return accompanied with Form 483.3 duly completed.

Lastly, the Secretary of Treasury clarified that the holding made in the Walmart Case only relates to the AMT calculation. The 51% disallowance of expenses incurred or paid to a related party not engaged in trade or business in Puerto or to the home office located outside of Puerto Rico, pursuant to Section 1033.17(a)(17) of the PR Code, continues to be in effect.

Effects of Option 94 Termination for LLC's

Limited Liabilities Companies ("LLC") that starting January 1, 2011 would have been treated as partnerships pursuant to the provisions of Section 1010.01(a)(3)(A) of the PR Code but elected to be taxed as corporations under the Puerto Rico Internal Revenue Code of 1994, as amended, ("Option 94"), during taxable year 2011 and 4 subsequent years ("Election Period") will start determining their tax responsibility as partnerships under the PR Code in taxable year 2016 and subsequent years.

On September 30, 2016, Treasury issued Administrative Determination No. 16-12 to clarify the tax effect of the termination of the Election Period of Option 94.

Conversion effects

An LLC that elected to be treated as a corporation under Option 94 and upon termination of the Election Period will be treated as a partnership under the provisions of the PR Code, will be treated as having transferred its assets and liabilities to its members in liquidation of the LLC on the last day of the taxable year that it will be taxed as a corporation ("Statutory Liquidation") and the members are deemed to have transferred such assets and liabilities immediately thereafter to a "new partnership".

When the members are individuals, the transfers will be treated as if the property was sold to its member and transferred to the new partnership at fair market value. When there is member which is a corporation, the transfer may be considered as an exempt liquidation if the corporate member owns 80% or more of the LLC interest and the transaction takes place between two entities taxed as corporations at the time of the liquidation. Even if the Statutory Liquidation is exempt, the accumulated earnings and profits of an LLC that operates in Puerto Rico on the last day of the taxable year for which Option 94 was applicable will be considered distributed during the taxable year commencing immediately after December 31, 2015, which means that they will be subject to a 10% income tax withholding at source in the case of corporate shareholders not engaged in trade or business in Puerto Rico.

When the partnership conversion occurs due to Option 94 termination and there is a foreign corporate member involved, Treasury has determined that it is not necessary for the LLC to request a ruling demonstrating that the purpose of the transaction is not avoiding income taxes. Those taxpayers that already requested the ruling have 90 days starting on October 1, 2016 to send a letter to the Assistant Secretary of Tax Policy requesting the withdrawal of the ruling.

Statutory Liquidation- Chain of Entities

In case of a Statutory Liquidation of an LLC that terminated its Option 94 election and that forms part of a chain of legal entities, Treasury has determined that, for purposes of determining whether the transaction is exempt, those pass-through entities which form part of the chain of legal entities that are not corporations will not be considered. As such, the Statutory Liquidation will be considered to take place between the LLC and the first corporation that forms part of to the chain of legal entities which possesses at least 80% of the direct or indirect control of the LLC.

Statutory Liquidation Notification

All LLC's that will be treated as partnerships upon termination of the Election Period starting in taxable

year 2016 must complete and file the new version of Form AS 6045 "Partnership or Limited Liability Company Classification Notification or Election" not later than the last day of the third month of the taxable year for which such notification or election will be effective. This new form must be filed along with Form 480.2 (EC) "Informative Income Tax Return Pass-Through Entity" corresponding to the taxable year commencing immediately after December 31, 2015.

In addition, as part of the filing of Form AS 6045 the LLC must include an analysis of the earnings and profits that will be considered distributed. The LLC must include the amount of applicable tax determined, if any, and file Form AS 6045 with the corresponding tax payment and Form 480.9 "Withholding Tax Payment", if applicable.

Publication of Private Rulings

On September 30, 2016 Treasury issued Tax Policy Circular Letter No. 16-06 to establish that public interest rulings and administrative letters issued privately to taxpayers will be published to the public on a no-name basis. The reason for publishing the private rulings on a no-name basis is to provide taxpayers a general disclosure of the official interpretation of Treasury as to the application of the PR Code or any other tax law, to specific facts or transactions represented by a particular taxpayer.

Treasury will publish a Private Ruling in a form of administrative determination for public release within 6 months after the issuance of the Private Ruling (the "Public Ruling"). The Public Ruling will not set forth the name of the taxpayers or any details which may lead to identify the taxpayer.

Starting October 30, 2016, taxpayers who file a ruling request must include with the filing of the request a draft of their proposed Public Ruling that will be issued by Treasury for public release. The draft shall also be available to Treasury in digital form. Failure to include a proposed draft of the Public Ruling with the ruling request will be considered by Treasury as an incomplete ruling request. Taxpayers who filed a ruling request prior to September 30, 2016 will receive, along with the ruling reply, a proposed draft of the Public Ruling. This draft may be prepared by Treasury or Treasury may request the taxpayer the preparation of the same.

Once Treasury issues a Private Ruling along with the proposed Public Ruling, the taxpayer will have 30 days after the issuance of the ruling reply to formally object the wording of the proposed Public Ruling. If the taxpayer does not formally object within the time prescribed, Treasury will publish the Public Ruling without the need for further approval or written consent from the taxpayer. A Final Notice of Publication will be

mailed to the taxpayer at least 30 days before the date of the public release.

If a taxpayer desires to formally object the wording of the proposed Public Ruling it must file an Objection Letter to the Assistant Secretary of Tax Policy explaining the reasons for the objection and explaining how the wording of the proposed Public Ruling affects the taxpayer's privacy. The Objection Letter should be accompanied with a filing fee of \$50 and a substituted draft of the Public Ruling. If Treasury does not agree with the wording of the substitute Public Ruling it will contact the taxpayer to schedule a meeting in person or by phone within a period of 30 days, which may be extended to no more than 60 days, from the date Treasury makes the initial contact with the taxpayer requesting an appointment. If the taxpayer or its representative fails to appear to the meeting without just cause, Treasury has the authority to publish the Public Ruling as initially drafted.

A taxpayer can further object to the publication of the Public Ruling by filing a complaint with the Assistant Secretary for Adjudicative Proceedings, within 30 days from the issuance of the Final Notice of Publication, in accordance with the applicable regulations issued by Treasury.



Because of the general nature of this newsletter, nothing herein should be considered as legal advice or a legal opinion. For further information about the contents of this newsletter, or should you need further assistance in connection with these matters, please contact the firm's Corporate – Tax Department.



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