



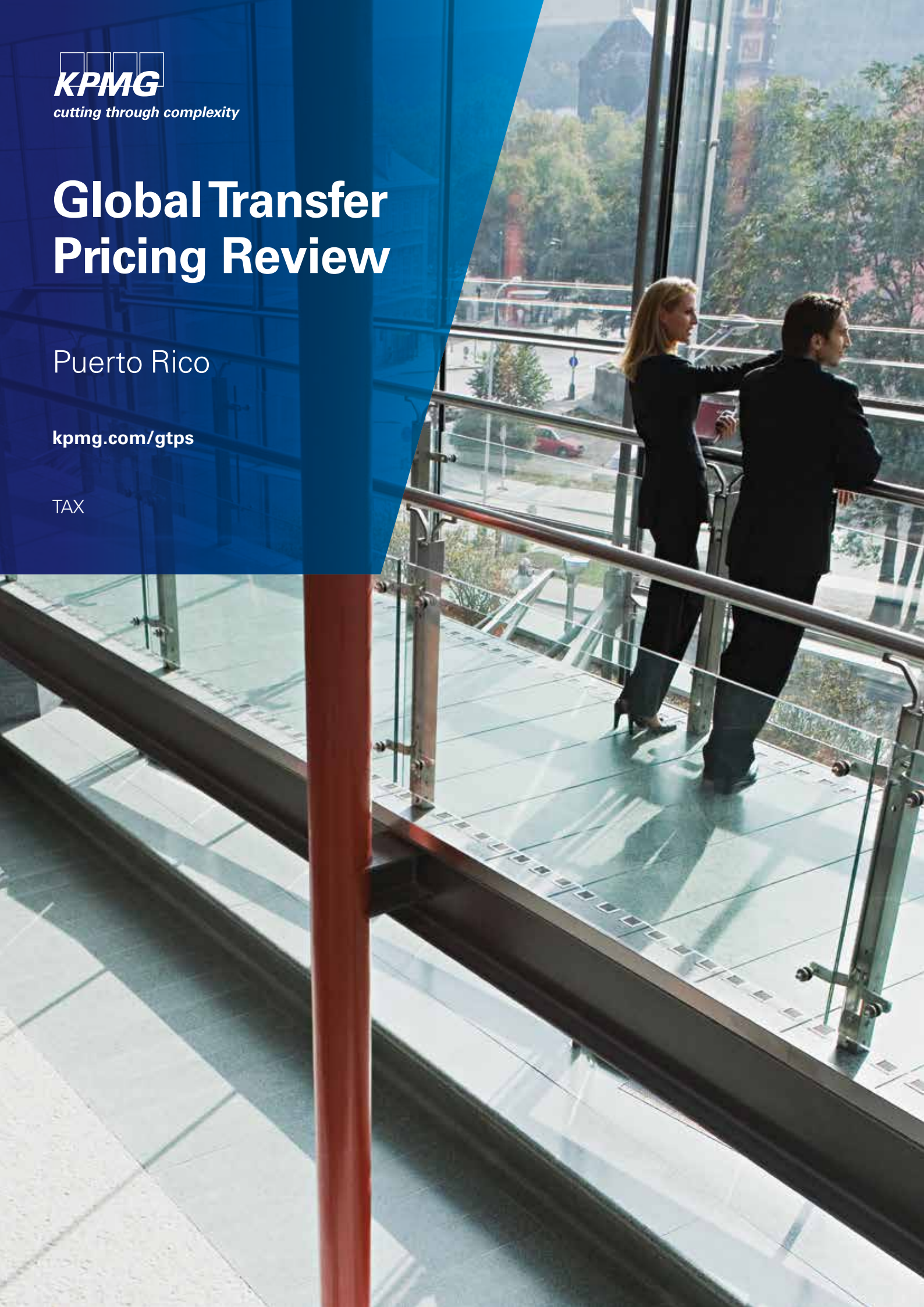
cutting through complexity

Global Transfer Pricing Review

Puerto Rico

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TAX



Puerto Rico



KPMG observation

After the termination of the Internal Revenue Code (IRC) section 936 election in 2006, some United States (US) companies decided to incorporate as non-US entities, subject to Puerto Rico tax rules. Any such companies should review their intra-group transactions to make sure they comply with local transfer pricing requirements.

In recent years, new non-transfer pricing provisions have been introduced into the Puerto Rico tax rules which nevertheless impact intra-group transactions. For example, inter- and intra-company charges are subject to a 51 percent disallowance for regular income tax purposes and those same charges are subject to a 20 percent tax for Alternative Minimum Tax (AMT) purposes. Thus, companies need to evaluate their intra-group transactions and the related impact of these new provisions.

Transfer pricing study snapshot

The purpose of a transfer pricing study

	Not applicable
Legal requirements	●
Protection from penalties	●
Reduce risk of adjustment	●
Shifts burden of proof	●

Basic information

Tax authority name

Departamento de Hacienda (Treasury Department).

Citation for transfer pricing rules

Articles 1047-1 to 1047-4 of the Puerto Rico Tax Regulation and Section 1040.09 of the Puerto Rico Internal Revenue Code of 2011, as amended (PRIRC).

Effective date of transfer pricing rules

21 January 2001 (Effective date of Regulations).

What is the relationship threshold for transfer pricing rules to apply between parties?

Parties are related when there is direct or indirect control, either legally established or just exercised. There is presumption of control if the income or deductions are arbitrarily manipulated.

What is the statute of limitations on assessment of transfer pricing adjustments?

Generally four years from the date the tax return is filed.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be submitted to the revenue authority on an annual basis (e.g. with the tax return)?

No. Puerto Rican taxpayers are not obliged to submit transfer pricing documentation to the tax authorities.

What types of transfer pricing information must be disclosed?

Under the revised statutory audited financial statements requirements, taxpayers with related entities operating

in Puerto Rico must file consolidated/combined audited financials and a reconciling schedule showing the results of operations of each of the entities and eliminating entries. An exception to the combined/audited financials has been approved for 2011, 2012 and 2013 to the extent that the related party name is mentioned in the notes of the audited financials.

What are the consequences of failure to submit disclosures?

Income tax return could be considered not filed.

Transfer pricing study overview

Can documentation be filed in a language other than the local language? If yes, which ones?

Yes, English or Spanish.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

No. Since there is no requirement to prepare a transfer pricing study, the authority has not adopted specific requirements with respect to contents when the taxpayer elects to submit a TP study. The only underlying requirement would be to show that the result is consistent with the applicable regulations.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

Transfer pricing methods

Does your country follow the transfer pricing methods outlined in Chapter II of the OECD Guidelines? If exceptions apply, please describe.

Not applicable.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? And if so, how many days?

Yes, 30 days.

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? Please explain.

Thirty days from the day requested. Extensions are generally granted.

If an adjustment is proposed by the tax authority, what dispute resolution options are available?

No special procedure is applicable. However, besides the competent authority, the taxpayer could request the assistance of the United States Internal Revenue Service (IRS) in cases involving a US jurisdiction and creating a potential double taxation issue.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

Yes, a deficiency will be assessed upon which interest and surcharges will be determined, which will be collected in the same manner as the tax. Interest consists of a 10 percent single annual rate and surcharge of 10 percent (one time).

To what extent are transfer pricing penalties enforced?

Always.

What defenses are available with respect to penalties?

None. Surcharge can only be removed at the discretion of the tax authority by execution of a closing agreement.

What trends are being observed currently?

Recent changes to the Internal Revenue Code shows the increasing attention that transfer pricing topic is receiving from the Government. However, the rules adopted deal with the subject matter indirectly by way of limiting in different ways the deductibility of intercompany charges.

Special considerations

Are secret comparables used by tax authorities?

No.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

No. Usually US companies are accepted as comparable companies.

Do tax authorities have requirements or preferences regarding databases for comparables?

No specific preferences.

Does the tax authority generally focus on the interquartile range in a TNMM analysis?

Not applicable.

Does the tax authority have other preferences in benchmarking? If so, please describe.

No specific preferences.

What level of interaction do tax authorities have with customs authorities?

Low.

Are there limitations on deductibility of management fees beyond the arm's length principle?

Yes, some. Beginning in 2013 in the case of management fees paid to a home office or a related entity not engaged in a trade or business in Puerto Rico, only 49 percent of such fees are deductible. Further, amounts equal to 20 percent of any such management fees and all other intercompany charges, are added to the regular Alternative Minimum Tax (AMT).

Are management fees subject to withholding?

No.

Are there limitations on the deductibility of royalties beyond the arm's length principle?

Yes. These are deductible only when paid, not just accrued.

Are royalties subject to withholding?

Yes.

Are taxpayers allowed to file tax return numbers that differ from book numbers?

Yes. If the year-end adjustment is performed prior to the closing of the fiscal year, the year adjustments are acceptable. Nevertheless, it is important to consider any impact from an indirect taxes perspective, as well as customs duties.

Other unique attributes?

None.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Minimal. There is a competent tax authority agreement in place between the Puerto Rican Treasury Department and the IRS intended to resolve disputes when a transaction is treated differently in both tax jurisdictions.

If extensive, is the competent authority effective in obtaining double tax relief?

Almost always.

When may a taxpayer submit an adjustment to competent authority?

When a double taxation issue has been identified.

May a taxpayer go to competent authority before paying tax?

Yes.

Advance pricing agreements

What APA options are available, if any?

None.

Is there a filing fee for APAs?

Not applicable.

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

Not applicable.

Are there any difficulties or limitations on the availability or effectiveness of APAs?

Not applicable.

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