



Transfer pricing in Puerto Rico: the conversation continues

June 15, 2018

If the proposed Tax Reform (H.R. 1544) is passed as presented to the Puerto Rico Legislature on April 16, 2018, the 2011 Puerto Rico Internal Revenue Code, as amended (PR Code) will suffer significant changes. The following are among the proposed changes that affect corporations: 1) a reduction in tax rates, 2) various changes to the alternative minimum tax, 3) limitation on certain deductions. We want to highlight one particular proposal, which would have a positive impact on most corporations that have transactions with related entities outside PR.

The PR Code establishes a 51% limitation on the amount of deductions that an entity can take for expenses paid to related entities outside PR or on allocations of expenses made to the Puerto Rico entity. This disallowance has been subject of debate since it was established in 2013. The most renowned public debate on the subject came as a result of the case *Wal-Mart Puerto Rico, Inc. v. Juan C. Zaragoza Gómez*, Civil No. 3: 15-cv-03018(JAF). However, in this case the Court ruled only on the alternative minimum tax impact related to these expenses. The disallowance of the deductions was not specifically addressed. Subsequently, the Puerto Rico Treasury Department issued Administrative Determination 16-11, confirming that the disallowance was still in effect.

The proposed tax reform maintains the 51% disallowance as it is now, but with one important exception. The exception provides that an entity that has made a transfer pricing study to support the charges from related entities will not be subject to the 51% disallowance. It also establishes that the rules to be followed for the transfer pricing study will be those presented on Section 482 of the United States Internal Revenue Code of 1986, as amended and its regulations.

An important aspect of this proposal is that unlike most of the proposed changes, which will be effective for 2019, this particular provision will be effective for 2018.

For additional information, visit our Professional Articles on: www.grantthornton.pr

What can you do to be prepared?

First, determine if your company has been affected by the 51% disallowance in prior years' tax returns. Second, stay tuned to the final language that will be approved by the Legislature (this should be final on or before June 30 unless the project is moved to an extraordinary session in July). Third, you need to start working on a transfer pricing study to cover your intercompany charges for 2018.

Affected companies should prepare a preliminary transfer pricing study before year end so that they can make any necessary adjustments on the intercompany charges and then complete the study with actual yearend information.

We will keep you informed about the status of this legislation.
Please contact us to discuss your particular case.



María de los Angeles Rivera
Partner Head of Tax and
IBC Director
E maria.rivera@pr.gt.com



Lina Morales
Tax Partner
E lina.morales@pr.gt.com



Francisco Luis
Tax Partner
E francisco.luis@pr.gt.com



Isabel Hernández
Tax Partner
E isabel.hernandez@pr.gt.com



DISCLAIMER: This update and its content do not constitute advice. Clients should not act solely on the basis of the material contained in this publication. It is intended for information purposes only and should not be regarded as specific advice. In addition, advice from proper consultant should be obtained prior to taking action on any issue dealt with this update.

© 2018 Kevane Grant Thornton LLP All rights reserved. Kevane Grant Thornton LLP is a member firm of Grant Thornton International Ltd (GTIL). GTIL and the member firms are not a worldwide partnership. Services are delivered by the member firms. GTIL and its member firms are not agents of, and do not obligate, one another and are not liable for one another's acts or omissions. Please visit www.grantthornton.pr for further details.