



Jesús F. Méndez Rodríguez  
Secretary of the Treasury

March 31, 2011

### INFORMATIVE BULLETIN FROM INTERNAL REVENUE NO. 11-08

**ATTENTION: ALL TAXPAYERS SUBJECT TO THE EFFECTIVELY CONNECTED INCOME SOURCE RULE OF SECTION 1123(f) OF THE PUERTO RICO INTERNAL REVENUE CODE OF 1994, AS AMENDED.**

**SUBJECT: QUESTIONS AND ANSWERS WITH RESPECT TO THE APPLICATION OF THE EFFECTIVELY CONNECTED INCOME SOURCE RULE OF SECTION 1123(f) OF THE PUERTO RICO INTERNAL REVENUE CODE OF 1994, AS AMENDED.**

Act 154 of October 25, 2010, as amended, introduced changes to the effectively connected income source rules under Section 1123(f) of the Puerto Rico Internal Revenue Code of 1994, as amended (Code)<sup>1</sup>. As a result of such changes, new rules were established to determine when a nonresident individual or a foreign corporation or partnership is deemed engaged in trade or business in Puerto Rico and deriving effectively connected income with the conduct of a trade or business within Puerto Rico sources (the "ECISR").

The Treasury Department has received numerous questions regarding the application of the ECISR. This Informative Bulletin provides answers to the most common questions asked by the taxpayers.

---

<sup>1</sup> Act No. 1 of January 31, 2011, also known as the "Internal Revenue Code for a New Puerto Rico" (hereinafter, the "New Code"), replaced the Code. According to Section 1035.04 of the New Code, the provisions of Section 1123(f) and (h) of the Code shall remain in effect.


## QUESTIONS AND ANSWERS

### **1. What form must be used to report income under the ECISR of Sections 1123(f)(4)(A)(ii) and (B) of the Code?**

In the case of a corporation subject to the tax the corporation should use Form 480.20 (Corporation Income Tax Return). The Treasury Department will issue shortly the schedule that should be completed by each taxpayer subject to the tax. The new schedule will reflect the entire net income of the entity and based on the applicable factors the net income attributable to Puerto Rico sources under the ECISR will be determined. Such schedule will be part of Form 480.20.

Where a taxpayer must compute entire net income based on Puerto Rico tax law (because its jurisdiction of organization does not impose a tax on net income), the taxpayer should prepare a pro forma Puerto Rico return and reflect the entire net income figure from such pro forma return on the new schedule and then complete the new schedule in the same manner as an entity that is subject to income tax in its jurisdiction of organization.

### **2. How is income allocated to Puerto Rico under the ECISR?**



In general, a taxpayer must determine its income subject to Puerto Rico tax under the ECISR by multiplying its entire taxable net income (generally computed under the taxation rules of the jurisdiction in which it is organized) by a fraction, the numerator of which is the sum of the property factor, the payroll factor, the purchases factor and the sales factor and the denominator of which is four. The denominator is four even if one or more of the factors are zero.

### **3. What employer identification number should the entity use, if the entity does not have a federal employer identification number?**

It is mandatory that the taxpayer uses its US federal employer identification number in its return. If the taxpayer is a foreign entity that does not have or wish to request a federal employer identification number, then an employer identification number must be requested from the PR Treasury Department by completing the pertinent parts of Form SC 4809 (Information of Identification Number – Organizations (Employers)). Line 1 must be left blank. The application should be filed via email to [TaxpayerIDRequest@hacienda.gobierno.pr](mailto:TaxpayerIDRequest@hacienda.gobierno.pr).

The number issued by the PR Treasury Department must then be used for all future transactions and reporting to the PR Treasury Department by that entity.

#### **4. What is a taxpayer's taxable year for this purpose?**


Where the taxpayer properly elects to use a taxable year other than a calendar year (a fiscal year), the taxpayer should compute the tax based on that taxable year. In the case of a taxpayer having a fiscal year ending in 2011, a taxpayer reporting income under the ECISR must generally report income for the period beginning January 1, 2011 and ending on the last day of the fiscal year.

#### **5. Must a taxpayer make estimated payments of tax due under the ECISR?**

Yes, a taxpayer must comply with the rules relating to estimated tax payments pursuant to Section 1060 of the Code (1061.23 under the New Code).

The estimated tax installments are to be paid together with a payment coupon (Form 480.37 on our website), however, payments may be made without a coupon using Colecturia Virtual at [www.hacienda.gobierno.pr](http://www.hacienda.gobierno.pr).

#### **6. When is the return due?**



The income tax return for the taxable year 2010 of domestic or foreign corporations and partnerships engaged in trade or business in Puerto Rico must be filed on or before the fifteenth day of the fourth month following the end of the taxable year. In the case of a foreign corporation or partnership not having any office or place of business in Puerto Rico, the return must be filed on or before the fifteenth day of the sixth month following the end of the taxable year.

A copy of the income tax return filed in the jurisdiction in which the taxpayer is organized, if such jurisdiction imposes an income tax, must be included with the Puerto Rico income tax return. If the jurisdiction does not impose an income tax on the taxpayer, then the entire taxable net income must be computed under the Puerto Rico income tax laws.

#### **7. What is the applicable tax rate?**

The applicable tax rate is the tax rate to which a taxpayer is ordinarily subject to tax. For most corporate taxpayers, the rate would reflect the normal tax and the surtax. Any surtax credit available to a controlled group must be allocated among the members of that group in accordance with the allocation rules. For the taxable year 2010, the 5% special additional tax is also applicable.


#### **8. Since an amount of income is determined to be income effectively connected with the conduct of a trade or business within Puerto Rico that is from sources with Puerto Rico, can deductions be claimed, or is the tax computed on a gross basis?**

The income that is treated as effectively connected with the conduct of a trade or business within Puerto Rico under the ECISR is an allocated portion of a taxpayer's entire taxable net income. The taxpayer's entire taxable net income already reflects allowable deductions. No additional deductions are permitted.

**9. Is the use of net operating loss carryforwards and carrybacks permitted in computing entire taxable net income?**

It is anticipated that the regulations will be revised to provide that net operating losses arising in taxable years in which a taxpayer is subject to the ECISR would be permitted in computing entire taxable net income, subject to the income tax rules in the jurisdiction in which the taxpayer is organized, provided that such jurisdiction imposes an income tax on the taxpayer. If the jurisdiction does not impose an income tax on the taxpayer, then no use of net operating losses would be permitted. Net operating losses arising in taxable years in which the taxpayer is not subject to the ECISR would not be permitted to be used for computing entire taxable net income for purposes of the ECISR.

**10. How should a taxpayer compute its Puerto Rico income tax if that taxpayer is a foreign person that is (i) itself subject to income taxation in Puerto Rico without regard to the ECISR and (ii) also subject to tax under the ECISR?**



It is anticipated that regulations will be issued that would provide that the taxpayer would separately compute its tax on its operations without regard to the ECISR and would also compute its tax pursuant to the ECISR. The income tax paid with respect to the tax computed without regard to the ECISR would be able to be credited against the income tax owing under the ECISR. If the income tax paid with respect to the tax computed without regard to the ECISR exceeds the income source rule tax, there would be no refund. Dividends, other than those subject to tax in Puerto Rico, would be included in entire net income. It is anticipated that amendments to the regulations will exclude dividends that are subject to tax in Puerto Rico from entire net income.

**11. Can income tax credits generated under tax incentives laws (e.g. credits generated by a manufacturing entity under Act 73 of May 28, 2008 and purchased transferable credits) be used to offset tax liability under the ECISR?**

The ECISR imposes the income tax on certain purchasers of a person that engages in manufacturing or production or the provision of manufacturing services in Puerto Rico. That purchaser is liable for the tax. Only those credits of that purchaser, including transferable credits acquired by the purchaser, may be used to offset the purchaser's tax. Other credits of other members of the purchaser's controlled group may not be used to offset the purchaser's tax.

**12. Does the branch profits tax, the alternative minimum tax or the accumulated earnings tax apply to taxpayers subject to the ECISR?**

It is anticipated that regulations will be issued that would provide that the branch profits tax, the alternative minimum tax and the accumulated earnings tax will not apply to a taxpayer that is solely subject to tax as a result of Sections 1123(f)(4)(A)(ii) and (B) of the Code.

**13. Will additional guidance be issued dealing with the ECISR?**

As noted above, it is anticipated that limited additional amendments to Regulations 7971 of December 29, 2010 will be issued addressing certain issues.

For additional questions regarding the ECISR of Section 1123 of the Code, you may contact us by email to [balvarez@hacienda.gobierno.pr](mailto:balvarez@hacienda.gobierno.pr).

Cordially,



Jesus Méndez Rodríguez