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GLOBAL TRANSFER PRICING SERVICES

Global Transfer Pricing Review

Puerto Rico

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TAX



Puerto Rico



KPMG observation

After the termination of Internal Revenue Code (IRC) section 936 election, some United States' (US) companies decided to incorporate as a non-US entity, subjected to Puerto Rico tax rules. Therefore, companies should review their intra-group transactions to make sure these comply with local transfer pricing requirements.

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 4 years from the date the tax return is filed.

Transfer pricing disclosure overview

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

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 prepare or submit disclosures?

Income tax return could be considered not filed.

Transfer pricing study overview

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

No.

Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?

It is useful to taxpayers to have a transfer pricing study since it is valued by the tax authorities and provides a framework for the tax audit.

To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?

No.

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.

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

Are transfer pricing methods outlined in Chapter II of the OECD Guidelines acceptable?

Yes.

Is there a priority among the acceptable methods?

Under the provisions of Article 1047-3 of the Regulations, the methods must be evaluated following a hierarchical order. That is, the taxpayer must evaluate the transaction using the following methods in the order prescribed:

- comparable uncontrolled price (CUP)
- resale price
- cost plus
- any other method.

If there is no priority of methods, is there a “best method” rule?

Not applicable.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer’s transfer pricing documentation, how long does the taxpayer have to submit its documentation?

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

If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?

No special procedure is applicable. However, besides the competent authority, the taxpayer could request the assistance of the US 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 defences 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 show the increasing attention that transfer pricing topic is receiving from the Government. The Secretary of Treasury has publicly indicated that the agency is working on a Transfer Pricing Regulation that should be available sometime between 2014 and 2015.

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.

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

Low.

Are management fees deductible?

As a general rule, yes. However, 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, if services are provided outside of Puerto Rico. Yes, to the extent they are paid to only that portion of services rendered in Puerto Rico and paid to a foreign entity not engaged in a Puerto Rico trade or business, a 29 percent withholding tax is applicable.

Are year-end transfer pricing adjustments permitted?

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.

Other recent developments

The AMT formula has recently been revised again. Now AMT includes components like 20 percent of intercompany charges and two percent of intercompany purchases. Also, for regular income tax purposes intercompany charges, including management fees, are subject to a 51 percent disallowance. Treasury has approved a procedure to grant exemption, upon request, for expenses paid to a third party and allocated to the Puerto Rico business and expenses that are essential to running the business.

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 Advance Pricing Agreement (APA) options are available, if any?

No APAs or advance rulings of any kind.

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.

Please provide some information on how successful the APA program is and whether there are any known difficulties?

Not applicable.

Language

In which language or languages can documentation be filed?

English or Spanish.

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Publication name: Global Transfer Pricing Review

Publication number: 133196

Publication date: June 2014