

Daily Tax Report ®

Companies in Puerto Rico Face Deadline on US Foreign Tax Credit

By Angélica Serrano-Román and Michael Rapoport

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- Guidance gives companies until Dec. 31 to amend tax decrees
 - Puerto Rico Treasury to create an expedited procedure
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Companies will have to rush to decide whether to amend their long-term Puerto Rican tax agreements to continue receiving US foreign tax credits for tax payments they make in the US territory.

In the wake of new US foreign tax credit rules and a Puerto Rico tax-law overhaul in June, taxpayers were waiting for the IRS to ensure that changing their tax decrees wouldn't result in them losing access to the foreign tax credit.

The IRS gave them what they wanted but put them on a clock, tax practitioners said: If companies want to amend their agreements in order to continue to claim the credit—to switch to the new income tax and royalty withholding tax framework under Puerto Rico's [Act 52](#)—they will have to do so by Dec. 31, under the IRS [notice](#) issued last Friday.

"It doesn't give companies a lot of time to make the decision and renegotiate their agreements; they will have to do so in little more than three months," said Jason Yen, principal at EY's International Tax and Transaction Services and former associate international tax counsel in the US Treasury Department.

To mitigate a time crunch for taxpayers, the local government will create an "expedited procedure" to approve these amendments.

With the expedited process, the approvals are expected to take weeks rather than over a year, said Giancarlo Esquilín Lebrón, a Puerto Rican CPA and tax partner at local firm THRIV LLC. Act 52 also provides "expedited resolution" of administrative procedures, including any certification required to obtain an exemption within the tax code.

Not everyone agrees that companies don't have a lot of time. Because the IRS move had been widely expected, companies that want to amend their decrees shouldn't face too much of a problem making the deadline, said Pat Brown, co-leader of PricewaterhouseCoopers LLP's Washington National Tax Services practice.

"I would be very surprised if there's any sort of time crunch for taxpayers here," he said.

Not all companies will need to modify their decrees since it will vary by the taxpayer, said Kenneth Rivera Robles, CPA and treasurer of the Board of Directors of the Puerto Rico Manufacturing Association. He said one of the industry's concerns is not being able to request an amendment after the December deadline.

"Many people don't know what to do yet, and others were considering an amendment for next year. The IRS notice doesn't address that," Rivera Robles added.

'Noncompulsory'

The problem began with regulations the US Treasury issued last December that tightened eligibility requirements for companies to be able to apply their payments of foreign taxes to their US tax bills. Among other things, the regulations indicated a Puerto Rican excise tax—the territory's 4% tariff on products made in Puerto Rico and purchased by the manufacturer's parent company—would no longer be eligible for the foreign tax credit starting in 2023.

That helped lead to Act 52, in which Puerto Rico's Treasury swapped the excise tax for a local income tax. But it also created concerns that some taxpayers who chose to amend their Puerto Rican tax agreements would end up making "noncompulsory payments"—payments in excess of what they were required to pay—that wouldn't be eligible for the foreign tax credit either.

Under the guidance issued Friday, any excess payments taxpayers make to Puerto Rico won't be considered "noncompulsory payments."

What the IRS did was to revise its way of determining whether payments were considered excess and thus noncompulsory, Brown said. Under the previous Puerto Rican law, it was the US affiliate that paid the tax, but under the new law, it's the Puerto Rican entity, he said. So, in isolation, the Puerto Rican entity's taxes have gone up, raising the question of whether it was making excess payments.

Under the notice, the new method is to consider whether an entity is paying more than it has to under "generally applicable" Puerto Rican law, Brown said. If the answer is no, it's not excess and not noncompulsory, and thus a company can continue to be eligible for the foreign tax credit.

Bloomberg Tax asked almost a dozen companies in Puerto Rico if they plan to amend their tax agreements under the new terms and comment on the IRS notice. Eli Lilly and Co. and Honeywell International Inc. declined to comment; others didn't respond.

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