



Tax News for Corporations Subject to Alternative Minimum Tax

By Sandra M. Torres-Martínez

Wal-Mart Puerto Rico, Inc. v. Juan C. Zaragoza Gomez ("Wal-Mart PR") Tax Case at a Glance

As you probably know, Act 40-2013 enacted certain changes in the computation of the alternative minimum tax ("AMT") to corporate taxpayers. In a nutshell, and subject to certain exceptions, the AMT was the excess of the higher of the following computations when compared to the regular tax:

1. 30% of the alternative minimum net income, or
2. 20% of related party or home office charges plus 2% of inventory purchases to parent company or affiliates ("AMT computation #2").¹

Afterwards, Act 72-2015 modified the applicable tax rate for the intercompany purchases portion of the computation mentioned above to, in general terms, a range from 2.5% to 6.5% depending on the entity's gross income derived from the conduct of a trade or business in Puerto Rico.

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On December 4, 2015, Wal-Mart PR filed a complaint before the United States District Court for the District of Puerto Rico ("District Court") seeking an injunction against continued enforcement of the AMT and moreover, a ruling that the AMT was unlawful under the Dormant Commerce Clause, the Equal Protection Clause, and the Bill of Attainder Clauses of the United States Constitution, as well as under the Federal Relations Act.²

On March 28, 2016, the District Court declared unlawful, under both federal constitutional and statutory law, the AMT computation highlighted on item number 2 above (i.e. Sections 1022.03(b)(2) and (d) of the 2011 Code). Furthermore, it stated that:

"The Puerto Rico Secretary of the Treasury and all of his or her subordinates must stop all levying, collection, and enforcement of the AMT under enjoined subsections, including as an estimated payment.... and other applicable section."
(Emphasis ours).³

The District Court's decision was appealed by the Puerto Rico Treasury Department ("PRTD") before the United States Court of Appeals for the First Circuit ("First Circuit Court"). On August 24, 2016, the decision of the District Court was upheld by the First Circuit Court. Subsequently, the PRTD informally announced that it did not plan to appeal the decision before the United States Supreme Court.

The First Circuit Court's decision brought an additional set of questions to those taxpayers which had been subject to the AMT under the computation #2 above. We may ask, what does this mean to AMT payments made under computation # 2? How does this decision impact 2016 estimated tax payments already filed? Will the decision apply to payments made under the AMT computation #2 before the enactment of Act 72-2015?

Administrative Determination No. 16-11 ("AD 16-11")

The PRTD recently issued a formal communication under AD 16-11 that provides its position

regarding the applicability of the First Circuit Court's decision and the process to request possible refunds or credits. This communication provides certain guidance regarding some of the questions above.

1. **Taxable years that commenced on January 1, 2016 and thereafter** - AD 16-11 states that for the taxable years that commenced from January 1, 2016 and thereon, no taxpayer will be subject to the AMT computation #2.

Furthermore, it also states that for the estimated tax computation for such taxable years, if the payments already made during 2016 fully satisfied the requirements of the provisions of Section 1061.23 of the 2011 Code⁴ (without taking into consideration the AMT computation #2), no further estimated payments will be required.

2. **Taxable year 2015** - The PRTD acknowledges that all taxpayers have the right to determine their AMT for such year without taking into consideration the AMT computation #2. Therefore, if the amount of AMT paid with the original return exceeds the revised AMT computation, the taxpayer will have the right to claim a credit for the excess tax paid.

a. If AMT computation #2 was paid: The taxpayer is given two options to use the credit that arises from the excess tax paid. The first option is not to amend the income tax return for the year 2015 and use the excess as if it were an AMT credit. If this option is elected, the taxpayer will face the limitations that an AMT credit has. The second option is for the taxpayer to amend the return and claim the excess payment as a credit to the estimated tax for taxable year 2016. If this option is elected, the taxpayer should submit with the amended return Form 483.3, Transmittal Form – Appendix A Corporation - Part V Taxable Year 2015. Furthermore, AD 16-11 states that a request for refund will not be granted.

b. If the income tax return for the taxable year 2015 has not been filed: The PRTD stated that these returns must include Form 483.3. If the AMT computation #2 was paid,

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Sandra provides corporate and expatriate tax services for clients in the manufacturing, advertising, retail and health industries. Her experience includes representation before the U.S. Internal Revenue Service, the Puerto Rico Department of Treasury and other local tax authorities. She also has experience in the negotiation of tax exemption grants, research on income, property, excise and municipal licenses issues, as well as with the review and preparation of individual and corporate Puerto Rico and United States tax returns. She leads Alvarado Tax & Business Advisors' consulting practices for non-for-profit organizations and participates on a regular basis as speaker in seminars sponsored by the Puerto Rico Society of Certified Public Accountants related to taxation of non-profit entities and other tax issues.

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* *The author counted with the special collaboration of ATBA's Member Felipe Mariani-Franco in the development of this bulletin.*

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the credit will be applied to the estimated tax for the taxable year 2016.

3. **Link between AMT computation #2 and the fifty one percent (51%) disallowance on expenses incurred by the taxpayer paid to a related person or home office (Sections 1022.03(b)(2)(A) and 1033.17(a)(17) of the 2011 Code, respectively)** - AD 16-11 reminds taxpayers that the 2011 Code provisions regarding the disallowance for these expenses are still valid as these were not covered by the Wal-Mart PR's case.

ATBA Comments:

PRTD's interpretation of the Wal-Mart PR's case in AD 16-11 is not without controversy. The PRTD has made a narrow interpretation regarding the years covered under the First Circuit Court's decision and limited the requests for refunds. Furthermore, it has established that the decision does not apply to the disallowance on expenses incurred by the taxpayer paid to a related person or home office that is currently in the 2011 Code.

In addition, PRTD's interpretation that the unconstitutionality and illegality of the law started for years commencing after January 1, 2015 has many detractors. Under this interpretation, the PRTD is basically stating that that

amendments brought by Act 72-2015 are the ones which caused the unconstitutionality of the section of the 2011 Code and not that it was unconstitutional from its origin.

One area which we believe that the PRTD may be challenged by certain taxpayers is the limitation of the request for refunds. This, however, may be a moot issue for some due to the cumbersome and extremely lengthy process of claiming and obtaining a refund. Most taxpayers may have a better outcome claiming a credit than going through the refund process. Nevertheless, other taxpayers may only obtain tax relief by seeking a refund. Those taxpayers should evaluate the cost of the process, including the possibility of going to court to contest the limitation.

Regarding the 51% limitation on the disallowance of expenses incurred by the taxpayer paid to a parent company or affiliate, we believe that the PRTD interpretation has its basis. It is a fact that the court did not review the section of the 2011 Code which established this limitation nor that it declared this section unconstitutional or unlawful.

Entities that were subject to the above mentioned AMT computations should determine the impact, if any, on the Puerto Rico income tax returns previously filed and on estimated income tax payments for 2016. This analysis should not be limited only to the possible excess payments made but also to the possible alternatives of recouping those excess payments and the cost associated to the process.

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We are currently assisting various companies in determining the possible impact of this tax case on their AMT current and previous computations. We suggest that this determination be made before year end.

Notes

¹ Sections 1022.03(b)(2) and (d) of the Puerto Rico Internal Revenue Code of 2011, as amended (the "2011 Code").

² Wal-Mart PR, among other arguments, stated that it was subject to the maximum 6.5% tax rate on the intercompany purchases portion of the AMT computation and that as a result of that, its effective tax rate would have been 114% (page 41 of Case Civil No. 3:15-CV-03018 (JAF)).

³ *Ibid*, page 108.

⁴ Section 1061.23 of the 2011 Code establishes the requirement of estimated income tax payments for corporate taxpayers which includes the AMT. Among other things, it establishes the installments due dates for the current taxable year as the 4th, 6th, 9th and 12th month during such taxable year. For a taxpayer with a December 31st year end, such due dates will be April, June, September and December.

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