

Part III - Administrative, Procedural, and Miscellaneous

Puerto Rican Excise Tax

Notice 2011-29

On October 25, 2010, Puerto Rico enacted legislation amending the Puerto Rico Internal Revenue Code of 1994 (“PR IRC”). The legislation adds new rules (“Expanded ECI Rules”) to section 1123 of the PR IRC that characterize certain income of nonresident corporations, partnerships, and individuals (collectively, “nonresidents”) as effectively connected with the conduct of a trade or business in Puerto Rico (“PR ECI”) and therefore subject to Puerto Rican income tax. The legislation also adds new section 2101 to the PR IRC to impose an excise tax (“Excise Tax”) on a controlled group member’s acquisition from another group member of certain personal property manufactured or produced in Puerto Rico and certain services performed in Puerto Rico. Technical corrections to the legislation were enacted on October 28, 2010, and January 31, 2011. Final regulations relating to the Expanded ECI Rules and the Excise Tax were published on December 29, 2010. The Expanded ECI Rules and the Excise Tax are generally effective for income accruing and acquisitions occurring, respectively, after December 31, 2010.

Section 901 allows a credit against U.S. income tax for the amount of any

income, war profits and excess profits tax (collectively, an “income tax”) paid or accrued during the taxable year to any foreign country or to any possession of the United States. A foreign levy is an income tax only if (a) it is a tax and (b) the predominant character of that tax is that of an income tax in the U.S. sense. §1.901-2(a)(1) of the Income Tax Regulations.

Under section 903, an income tax includes a tax paid or accrued in lieu of an income tax that is otherwise generally imposed by any foreign country or by any possession of the United States. Section 1.903-1(a) provides that a foreign levy is a tax in lieu of an income tax only if it is a tax within the meaning of §1.901-2(a)(2) and it meets the “substitution requirement” of §1.903-1(b). A foreign levy satisfies the substitution requirement only if it operates in substitution for and not in addition to a generally imposed income tax or series of income taxes and only to the extent that liability for the foreign tax is not dependent (by its terms or otherwise) on the availability of a credit for the foreign tax against income tax liability to another country. §1.903-1(b)(1) and (2).

The IRS and the Treasury Department are evaluating the Excise Tax. The provisions of the Excise Tax are novel. The determination of the creditability of the Excise Tax requires the resolution of a number of legal and factual issues. Pending the resolution of these issues, the IRS will not challenge a taxpayer’s position that the Excise Tax is a tax in lieu of an income tax under section 903. This notice is effective for Excise Tax paid or accrued on or after January 1, 2011. Any change in the foreign tax credit treatment of the Excise Tax after resolution of the pending issues will be

prospective, and will apply to Excise Tax paid or accrued after the date that further guidance is issued.

Various personnel from the IRS and the Treasury Department participated in the development of this notice. For further information regarding this notice, contact Richard L. Chewning at (202) 622-3850 (not a toll-free call).