December 13, 1999

INFORMATIVE BULLETIN NO. 99-08

Attention: 936 Corporations

The 1993 amendments to the United States Internal Revenue Code of 1986, as amended (the "Federal Code"), subjected entities filing under Section 936 of the Federal Code ("936 corporations"), for taxable year 1994 and thereafter, to partial United States federal income taxation by gradually phasing-out the 100% income tax credit granted by such section. Additionally, the amendments provide that, to determine their federal income tax liability, 936 corporations can only claim a partial deduction for Puerto Rico income taxes paid or accrued on Puerto Rico source income.

As a general rule, under Sections 1231(b), 1233 and 1023(c)(2) of the Puerto Rico Internal Revenue Code of 1994, as amended ("PR Code"), a 936 corporation can deduct, for Puerto Rico tax purposes, income taxes imposed by the United States on income effectively connected with its conduct of a trade or business in Puerto Rico. However, Section 1131(h)(1)(B) of PR Code imposes conditions upon the allowance of the deduction under Sections 1223 and 1233, which can result in the disallowance of such deduction. Consequently, a portion of a 936 corporation's Puerto Rico source income could be subject to double taxation.

In view of our Government's public policy of promoting and furthering economic activity in Puerto Rico, this Department has determined to allow a deduction for the federal income taxes paid or accrued by 936 corporations on Puerto Rico source income derived from the active conduct of a trade or business in Puerto Rico (the Deduction), which Deduction shall be the lesser of (1) 6% of the Puerto Rico Source Net Taxable Income, or (2) the federal income taxes paid or accrued by the 936 corporation that are attributable (on a net-to-net basis) to the Puerto Rico source active trade or business income. The term "Puerto Rico Source Net Taxable Income" means the taxable income from Puerto Rico sources of the 936 corporation, determined under the PR Code, computed:

Before:

- the tax exemption provided under any of the Tax Incentive Acts (as defined herein),

- the Deduction (that is, the deduction described herein for federal taxes attributable to Puerto Rico source income),
- the computation of the base period income as provided by Act No. 135 of December 2, 1997 (the 1998 TIA), and

After:

- any deduction for net operating losses of prior years,
- any special payroll deduction provided under Act No. 26 of June 2, 1978, as amended (the 1978 IIA), and Act No. 8 of January 24, 1987, as amended (the 1987 TIA and, together with Act No. 57 of June 13, 1963, the 1978 IIA and the 1998 TIA, the Tax Incentives Acts); and,
- the special deductions provided under the 1998 TIA.

To be entitled to claim the Deduction, the 936 corporation must enter into a closing agreement with this Department. In general, the closing agreement shall provide the following:

1. The Deduction shall be allowed as a result of taxes paid in both jurisdictions over the same taxable income related to an active trade or business in Puerto Rico.

2. No Deduction shall be allowed for federal taxes attributable (on a net-to-net basis) to investment income, including income from investments described in section 2(j) of the Tax Incentive Acts.

3. The Deduction is allowed exclusively to 936 corporations. Regardless of whether it qualified for the Deduction for any prior taxable year, a corporation will not be entitled to such Deduction for any taxable year with respect to which it does not qualify for benefits under Section 936 of the Federal Code.

4. The Deduction allowed may be claimed for taxable years beginning after December 31, 1993 that are not barred by the statute of limitation.

5. The Deduction allowed may not reduce the total tax liability for any taxable year by more than fifty percent (50%).

6. No refund will be allowed as a result of the recomputation of a taxable year's Puerto Rico income tax liability to claim the Deduction.

7. A 936 corporation that has not claimed a deduction in prior years for federal taxes paid may claim the Deduction, subject to the conditions and limitations described in this Bulletin.

8. Any overpayment of Puerto Rico income taxes resulting from the Deduction may be credited against any future income tax liability until exhausted, subject to the limitation described in 5. above; provided that any and all unused overpayments resulting from the Deduction will expire on the last day of the taxable year following the taxable year for which the corporation qualifies for the benefits under Section 936 of the Federal Code.

9. If as a result of the limitation described in 5. above, a 936 corporation is not able to claim the full amount of the Deduction otherwise allowable in any given year, the unused amount may be carried over to, as federal income taxes paid or accrued in, subsequent taxable years for which the corporation has filed and qualified for benefits under Section 936 of the Federal Code, until exhausted; provided, however, that any and all unused Deductions will expire on the last day of the last taxable year for which the corporation qualifies for benefits under Section 936 of the Federal Code.

10. Special tax provisions contained in tax grants, including those providing for a minimum tax payment or any other tax treatment, shall continue in full force and effect.

This Informative Bulletin shall not apply to 936 corporations whose tax exemption grants provide special specific rules for the computation of a deduction for federal income taxes paid or accrued.

To request the benefits provided herein, a 936 corporation must submit a draft of a closing agreement to the Department not later than ninety (90) days after the effective date of this Informative Bulletin.

Unless its tax exemption grant provides for a deduction for federal income taxes paid or accrued on Puerto Rico source income, with special specific rules as to the computation thereof, a 936 corporation that does not elect the benefits provided herein shall not be entitled to the deduction for federal income taxes paid or accrued on Puerto Rico source income. However, such a 936 corporation can invoke the provisions of Article 6 of the Tax Coordination Agreement between the United States of America and the Commonwealth of Puerto Rico.

This Informative Bulletin shall be effective immediately.

Remember, Hacienda is at your service.

Xenia Vélez Silva