

Global Tax Alert

News from EY Americas Tax

Statement by US government official suggests proposed foreign tax credit regulations would not affect the credit claimed by US related parties for excise tax paid to Puerto Rico under Act 154

EY Tax News Update: Global Edition

EY's Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access information about the tool and registration [here](#).

EY Americas Tax

EY Americas Tax brings together the experience and perspectives of over 10,000 tax professionals across the region to help clients address administrative, legislative and regulatory opportunities and challenges in the 33 countries that comprise the Americas region of the global EY organization. Access more information [here](#).

United States (US) Treasury Assistant Secretary for Tax Policy David J. Kautter and Puerto Rico's Treasury Secretary, Francisco Parés Alicea, recently discussed the impact of the proposed foreign tax credit regulations on the excise tax paid to Puerto Rico under Act 154. According to a [press release](#) from Secretary Parés Alicea following the meeting, Assistant Secretary Kautter indicated that the proposed regulations were not intended to affect taxpayers' ability to claim a foreign income tax credit under Federal income tax law for Puerto Rico's excise tax under the Act 154 regime.

Overview

Act 154, enacted in October 2010, established a special 4% excise tax on the sale of products that are manufactured in Puerto Rico and acquired by a member of the manufacturer's controlled group. The special excise tax applies when the sum of the gross receipts from sales of personal property manufactured in Puerto Rico or services performed by a group member in Puerto Rico exceeds \$75 million for any of the preceding three years.

Taxpayers may claim various Puerto Rico tax credits against the special excise tax. Those credits include a general credit, a gross receipts alternative credit, an alternative credit based on taxable acquisitions, an incremental employment credit, a multiple municipalities facilities credit, a minority supplier credit, and a knowledge corridor and research and development investment credit.

Generally, US persons may claim a credit against their US income tax liability for certain income taxes paid, as well as taxes paid in lieu of an income tax. Due to certain novel features of the excise tax imposed by Act 154, its status as a creditable tax under US Federal income tax regulations was unclear. In 2011, however, the US Treasury Department and the Internal Revenue Service (IRS) issued Notice 2011-29, which provided that the IRS would not challenge a taxpayer's position that the excise tax could be claimed as a foreign tax credit against its US tax liability.

Newly proposed foreign tax credit regulations

On 29 September 2020, the US Treasury Department and the IRS released final and proposed regulations on determining allowable foreign tax credits and the allocation and apportionment of certain expenses. The proposed regulations would fundamentally revise the rules on the types of foreign income taxes that may be claimed as a credit against US tax liability. Among other things, the proposed regulations would require a tax to satisfy a jurisdictional nexus requirement to be creditable. Under that requirement, a tax must adhere to traditional nexus standards (e.g., a tax on business profits attributable to a permanent establishment determined under principles similar to Internal Revenue Code¹ Section 864(c)).

It is unlikely that the purchase of goods or services in a country – which is the basis for imposing the excise tax under Act 154 – would satisfy the jurisdictional nexus requirement. Accordingly, many feared that the proposed foreign tax credit regulations would prohibit US related parties from claiming the foreign tax credit for the excise tax.

Clarification on excise tax credibility

According to the [press release](#) from Secretary Parés Alicea, Assistant Secretary Kautter clarified that US related parties may continue claiming the foreign tax credit for the excise tax. The press release also indicated that Kautter clarified during their conversation that the proposed regulations are aimed at certain digital services taxes imposed by other countries.

News reports indicate that another US Treasury Department official affirmed that IRS Notice 2011-29 has not been revoked. Accordingly, taxpayers may continue to rely on IRS Notice 2011-29 to claim a credit for taxes imposed under Act 154.

Implications

In response to challenges posed by the expanding digital economy, novel extraterritorial taxes have proliferated in recent years. These taxes, which include digital services taxes, diverted profits taxes, and equalization levies, are imposed on income that would not, under traditional international tax norms, be subject to tax in the country imposing the tax. Instead, taxing jurisdiction is asserted by reference to factors such as destination, customers and market access. The proposed regulations are an attempt to limit the extent to which these taxes may be claimed as a credit against US tax liability.

Despite the potentially broad reach of the new jurisdictional nexus requirement, it appears that taxes imposed under Act 154 remain creditable as long as IRS Notice 2011-29 remains outstanding. Taxpayers should carefully monitor developments relating to that Notice going forward, as well as the progress of potential changes to the proposed regulations.

Endnote

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.

For additional information with respect to this Alert, please contact the following:

Ernst & Young Puerto Rico LLC, State and Local Taxation Group, San Juan

- ▶ Rosa M. Rodríguez rosa.rodriguez@ey.com
- ▶ Pablo Hymovitz Cardona pablo.hymovitz@ey.com

Ernst & Young LLP (United States), International Tax and Transaction Services

- ▶ Raymond Stahl raymond.stahl@ey.com

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EY Americas Tax

© 2020 EYGM Limited.
All Rights Reserved.

EYG no. 007140-20Gbl

1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com