



December 10, 2010

### **Proposed Excise Tax Regulations**

#### **Reg. § 2101(a)-1. Imposition of Excise Tax on Certain Personal Property and Services.**

- (a) **In General.**—Code sec. 2101 imposes an excise tax on the acquisition of personal property and services by one member of a controlled group from another member of such group equal to the applicable percentage (set forth in Code sec. 2101(b)(4)) of the value of such personal property and services.
- (b) **Liability for tax.**—The tax imposed by Code sec. 2101 is imposed on, and a liability of, the person acquiring such personal property and services.
- (c) **Definition of Personal Property and Services.**—
- (1) The terms “personal property” and “services” mean
    - (i) Tangible property manufactured or produced in whole or in part in Puerto Rico, and
    - (ii) Services performed in Puerto Rico in connection with the manufacture or production of tangible property.
  - (2) For purposes of this article, personal property and services are limited to personal property and services that are acquired from any person that engages in the manufacture or production of tangible property in Puerto Rico, or performs services in Puerto Rico in connection with the manufacture or production of tangible property, and that has had gross receipts in excess of seventy-five million (75,000,000) dollars for any of the three (3) preceding common taxable years (as defined in Reg. § 2101(c)-2(b)).



(3) A person will be treated as having manufactured or produced tangible property in Puerto Rico when such person satisfies one or more of the provisions of subdivision (i), (ii), or (iii) below.

**(i) Substantial transformation of tangible property.**—The tangible property is substantially transformed by such person through the activities in Puerto Rico of such person’s employees or contractors.

**(ii) Other manufacture of tangible property.**— Such person’s employees or contractors perform activities with respect to such property in Puerto Rico that that are substantial in nature. Without limiting this substantive test, the activities of such person’s employees or contractors in Puerto Rico will be considered to be substantial in nature if any assembly or conversion costs (direct labor and factory burden) attributable to such person’s employees or contractors in Puerto Rico account for twenty (20) percent or more of the total cost of the tangible property that is sold. If such costs account for less than twenty (20) percent of the total cost of the tangible property that is sold, whether the activities of such person’s employees or contractors will be considered to be substantial in nature will depend on the facts and circumstances of each case.

**(iii) Products covered by Tax and Industrial Incentives Acts.**— The tangible property consists of a product or an item of property that is treated as produced or manufactured by such person’s employees or contractors in whole or in part in Puerto Rico under a decree issued under Act No. 73 of May 28 2008, as amended, known as the Puerto Rico Economic Development Incentives Act of 2008; Act No. 135 of December 2, 1998, as amended, known as the Tax Incentives Act of 1998; Act No. 8 of January 24, 1987, as amended, known as the Tax Incentives Act of 1987; Act No. 26 of June 2, 1978, as amended, known as the Industrial Incentives Act of 1978; or any previous or subsequent industrial incentives legislation.

(4) A person will be treated as performing services in connection with the manufacture or production of property in Puerto Rico where such person performs services in Puerto Rico that are related to property that is manufactured or produced in Puerto Rico within the meaning of subparagraph (c)(3) above (“manufacturing services”).

(5) In no event will activities that do not occur in Puerto Rico constitute the manufacture or production of property in Puerto Rico for purposes of Code sec. 2101.



(6) In no event will mere packaging, repackaging, labeling, or minor assembly operations in Puerto Rico, without more, constitute the manufacture or production of property in Puerto Rico for purposes of Code sec. 2101.

(7) Tangible property manufactured or produced in whole or in part in Puerto Rico does not include any property that is subject to the provisions of Subtitle D of the Puerto Rico Internal Revenue Code of 1994, as amended.

(8) Tangible property manufactured or produced in whole or in part in Puerto Rico includes a computer program within the meaning of Reg. § 1123(h)-1(a)(3), irrespective of the physical or electronic or other medium used to effectuate the transfer of any such computer program by the person that manufactured or produced such computer program in Puerto Rico, where activities in connection with such computer program take place in Puerto Rico.

**(d) Example.—**

Pharmco performs the following activities in Puerto Rico with respect to four different pharmaceutical products: (i) with respect to Product A, Pharmco combines inactive and active ingredients into a formulation in bulk form; (ii) with respect to Product B, Pharmco combines inactive and active ingredients to produce a bulk product that will be combined, outside Puerto Rico, into a finished formulation; (iii) with respect to Product C, Pharmco converts bulk formulation into dosage forms; and (iv) with respect to Product D, Pharmco only places dosage forms into protective packaging that has been designed especially for Product D, and applies labels to the packaging that are designed to meet the regulatory requirements of different jurisdictions in which Product D is expected to be used, and which differ according to the requirements (such as the use of particular languages) of those jurisdictions. Pharmco has, for purposes of Code sec. 2101, manufactured Products A, B and C in Puerto Rico. Pharmco has not manufactured Product D in Puerto Rico.

**Reg. § 2101(b)-1. Definition of acquisition for purposes of Code sec. 2101(b)(1).**

**(a) Acquisition.—**

**(1) In General.—**For purposes of Code sec. 2101, an “acquisition” means any action, transaction, or series of actions or transactions by which any person or enterprise

(i) obtains or procures legal ownership or physical possession of tangible property that is described in Code sec. 2101(b)(1)(A) or



(ii) obtains or procures the benefit of services described in Code sec. 2101(b)(1)(B)

regardless of whether such person or enterprise is located within or outside Puerto Rico, and regardless of whether such person or enterprise is a separate legal entity from the person or enterprise from which such tangible property or services are obtained.

(2) An acquisition includes the electronic transmission or communication of a computer program from a location in Puerto Rico.

(3) For purposes of Code sec. 2101, an acquisition includes the transfer of personal property between places of storage, processing, sales or marketing that are owned or operated by the same corporation, partnership, or proprietorship where such places are in separate municipalities or other geographic locations inside or outside Puerto Rico, provided that the corporation, partnership, or proprietorship had gross receipts in excess of seventy-five million (75,000,000) dollars for any of the three (3) preceding common taxable years (as described in Reg. § 2101(c)-2(b)).

(4) Notwithstanding the foregoing, the term “acquisition” does not include a transaction described in Code sec. 1112(b)(4), (5), (6), or (8) where such transaction does not involve a change in location of tangible property.

**(b) Time at which acquisition occurs.—**

(1) **In general.**—For purposes of Code sec. 2101, an acquisition occurs on the day on which the tangible property that is acquired in such acquisition (or in the case of services, the tangible property to which such services relate) is transmitted or communicated or is first loaded onto a vehicle, or is placed in the custody of a common carrier of any kind, for transportation from the place at which such property was manufactured or produced in Puerto Rico.

(2) **Certain changes in procedure disregarded.**— For purposes of applying Code sec. 2101, any change after October 25, 2010, in:

(i) methods or procedures for scheduling production or transportation or

(ii) the number of entities acquiring property or services from a controlled group member operating in Puerto Rico

one of the principal purposes of which is to avoid or affect the timing of liability for the excise tax described in Code sec. 2101, shall be disregarded.



**(c) Acquisition from a person that engages in the manufacture or production of personal property or services having gross receipts of seventy-five million (75,000,000) dollars.—**

(1) Acquisitions described in Code sec. 2101(a)(1) are limited to acquisitions from a person or enterprise that engages in manufacturing or production or manufacturing services in Puerto Rico as described in Reg. § 2101(a)-1(c).

(2) The gross receipts of a person are determined under Reg. § 2101(c)-3(a).

(3) In the case of a controlled group having a common taxable year (as described in Reg. § 2101(c)-2(b)) other than the calendar year, a determination of whether the seventy-five million (75,000,000) dollar threshold of Code sec. 2101(b)(1) is met with respect to a member of such group shall be determined based on the member's common taxable year.

(4) If the seventy-five million (75,000,000) dollar threshold was not met for a member engaged in manufacturing and production or manufacturing services in Puerto Rico for the common taxable year ended in 2010, 2009, or 2008, but is satisfied for a subsequent common taxable year, then the tax imposed by Code sec. 2101 shall apply beginning with the first calendar quarter beginning after the end of such subsequent year. If a member has not been in existence for each of the three (3) preceding common taxable years, a determination of whether the seventy-five million (75,000,000) dollar threshold of Code sec. 2101(b)(1) is met shall be determined based on the member's gross receipts derived during its period of existence.

**Reg. § 2101(b)-2. Definition of Value of Personal Property and Services for purposes of Code sec. 2101(b)(2).**

**(a) Value of Personal Property and Services.—**

(1) **Bill for property or services.**—For purposes of Code sec. 2101(b)(2), a “bill” for personal property or services, or both, shall mean documentation of the price at which such property or services, or both, has been reported, by any member of the controlled group of which the person is a member, to have been purchased from the seller for purposes of determining income tax liabilities under the laws of Puerto Rico or any other jurisdiction. If no documentation of such price for such purposes has been created, or if such documentation has been created reporting different prices for the same goods or services to be used for income tax purposes in different jurisdictions, then no bill shall be treated as having been rendered within the meaning of Code sec. 2101(b)(2).



**(2) Fair market value.**—For purposes of Code sec. 2101(b)(2)(B), the fair market value of goods or services, or both, shall be the highest value at which the price of such property or services, or both, has been reported by any member of the controlled group of which the person is a member to have been purchased from the seller for purposes of determining income tax liabilities under the laws of Puerto Rico or any other jurisdiction during the preceding eighteen (18) months, provided, however, that where the acquiring person can demonstrate by clear and convincing evidence that transactions with unrelated parties with respect to substantially similar goods or services occurred at a lower price during the calendar month of the acquisition, such lower price shall be the fair market value.

**(3) Exclusion of separately priced publicly traded components.**—The value of personal property under subparagraph (a)(1) or (a)(2) shall not include the value of any component that (i) is of a kind which is actively traded on an established commodity exchange or market and (ii) is included by contract in the sales price of the personal property containing that component from a member of the controlled group to a person that is not a member of the controlled group at a price that is based on the price of the actively traded commodity obtained from a publicly available source of market data. The taxpayer shall provide the Secretary with financial and other records that are sufficient to verify the taxpayer's computations and other determinations pursuant to this subparagraph (a)(3). This paragraph shall apply only if it would have applied to the transactions of the acquiring person on October 24, 2010 had Code sec. 2101 been in effect on such date.

**(4) Acquisition of Services.** Where a person acquires services from a person that engages in manufacturing services in Puerto Rico, the value to be used in determining the tax imposed under Code sec. 2101 is the value of the personal property to which the services relate, and not of the services themselves.

**(5) Transfer Pricing Adjustments.**— If, as a result of tax compliance activities by a person or other members of its controlled group, a person or such group adjusts, for purposes of tax compliance in any jurisdiction, the prices of property by reference to which the person's excise tax under Code sec. 2101 has been determined, then, subject to the rules of this subparagraph (a)(5), the prices as so adjusted may be used for purposes of determining the taxpayer's excise tax under Code sec. 2101, provided the prices as so adjusted reflect fair market value. Such adjustment must be reflected on an amended excise tax return for a calendar quarter that is filed within twenty and one half (20½) months following the month of the acquisition to which any such adjustment relates. If a controlled group adjusts any price under this subparagraph (a)(5) to reflect a lower acquisition cost, the controlled group must also adjust under this subparagraph (a)(5) all prices of any property that, pursuant to its review process, are adjusted, including those



that are increased and reflect a higher acquisition cost. In no event shall any price of property as adjusted pursuant to this subparagraph (a)(5) be lower than the highest price at which the price of such property has been reported, by any member of the controlled group of which the taxpayer is a member, for purposes of determining income tax liabilities under the laws of Puerto Rico or any other jurisdiction. The amount of any reduction in excise tax paid for a calendar quarter as a result of the adjustments described in this subparagraph (a)(5) may be used only as a credit to reduce the excise tax owing for any period subsequent to the adjustment; and in no event shall a refund be paid as a result of the application of this subparagraph (a)(5). If adjustments pursuant to this subparagraph (a)(5) result in an increase in excise tax for a calendar quarter, the amount of such increased excise tax shall be paid with the amended return for such calendar quarter. The potential for adjustments under this subparagraph (5) does not affect the obligation to make timely deposits of tax in accordance with Code sec. 2102(a) and to file timely returns in accordance with Code sec. 2103(a) based on the transfer prices in effect at the time of the acquisition. Subject to the requirements of this subparagraph (5), the controlled group and the Secretary may enter into a closing agreement under Code sec. 6126 to agree upon the effect of, and matters related to, changes in transfer prices that may take place between members of the controlled group.

**(6) Examples.—**

*Example 1.* Company A manufactures Product X in Puerto Rico. Company A regularly sells Product X to Company B, a member of the same controlled group as Company A. One or more members of the controlled group of which Company A and Company B are members reported a price of \$100 in a transaction for Product X in June 2010. Company B sells Product X to unrelated Companies C, D, and E in separate transactions in January 2011 at a price of \$80, reflecting a decline in the market value of Product X. Also in January 2011, Company B acquires Product X from Company A. Because Company B is able to demonstrate by clear and convincing evidence that transactions with unrelated parties with respect to substantially similar goods or services occurred at a lower price during the calendar month of the acquisition, the fair market value of Product X for purposes of Code sec. 2101 is \$80.

*Example 2.* Company A manufactures Product X in Puerto Rico. Company A procures precious metal D, which is an ingredient in Product X. Precious metal D is an actively traded commodity for which market price data is available from public sources. Company A sells Product X to Company B, a member of the same controlled group as Company A, for \$80 in a transaction subject to the excise tax under Code sec. 2101. At the time of this sale, the precious metal D component of Product X is valued at \$60, based on the market value for precious metal D at the time. Company B later resells Product X to an unrelated customer for \$100 at a time when the value of the precious



metal D component is \$70. The pricing of Product X to the customer is based on and would fluctuate based on a market price index for precious metal D. The value upon which excise tax is imposed on the acquisition by Company B is \$20, representing the \$80 amount billed less the \$60 precious metal D content at the time of acquisition.

*Example 3.* The facts are the same as in Example 2 except that Product X is a semi-finished product that is processed into finished Product Y by Company B outside of Puerto Rico, and Company B then sells finished Product Y to an unrelated customer at a price that is based on and would fluctuate based on a market price index of precious metal D. The result is the same as in Example 2, with the precious metal D content of Product X at the time of acquisition by Company B excluded from the value upon which excise tax is imposed.

**Reg. § 2101(c)-1. Definition of Controlled Group for purposes of Code sec. 2101(b)(4).**

**(a) General rule.**—The term "controlled group" has the meaning assigned to the term "controlled group of corporations" by Code sec. 1028(a), except that the phrase "at least 80 percent" shall be substituted by the phrase "more than 50 percent" each place it appears therein, and Code sec. 1028(b) shall not apply.

**(b) Special rules.**—

**(1)** An individual and any other person shall be treated as members of the same controlled group if any loss realized from the sale or exchange of property between such individual and such other person would not be allowed under Code sec. 1024(b).

**(2)** Separate places of storage, processing, sales or marketing that are owned or operated by the same corporation, partnership, or proprietorship in more than one municipality or other geographic location inside or outside Puerto Rico shall be treated as separate members of the controlled group.

**(3)** For purposes of determining whether the ownership requirements described in Code sec. 1028(a) as modified by paragraph (a) are met, a partnership or any entity that is not a corporation, as such terms are defined in Code sec. 1411, will be treated as a corporation and, for such purposes any references in Code sec. 1028 to the term "stock" shall include partnership interests and any types of ownership interests in other types of entities.

**(4)** For purposes of Chapter 7 of Subtitle B, a person may not be regarded as a member of more than one controlled group. If any person would otherwise be regarded as a member of more than one group, then such person and each controlled group of which it





could be regarded as a member must submit a request to the Secretary, and the Secretary shall determine the component members of the controlled groups.

**Reg. § 2101(c)-2. Definitions of Period and Common Taxable Year for purposes of Code sec. 2101(b)(4).**

**(a) Definition of period.**—For purposes of Code sec. 2101(b)(4), a “period” shall mean the calendar year or a portion thereof.

**(b) Common Taxable Year.**—In general, the common taxable year of a controlled group, for purposes of the seventy-five million (75,000,000) dollar threshold in Code sec. 2101(b)(4) and the ten (10) percent tests in Code sec. 2101(c), is the taxable year of the common parent of the controlled group. However, the members of the controlled group may elect the taxable year of one of the members of the controlled group other than the common parent to serve as the common taxable year of the controlled group. In the event that no common parent exists and that no common taxable year election has been made, the common taxable year of the controlled group will be the calendar year.

**(c) Election.**—An election of a common taxable year other than the calendar year must be made by the controlled group by filing a statement with the return for the period ending March 31, 2011 setting forth the common taxable year for the controlled group.

**Reg. § 2101(c)-3. Definition of Gross Receipts for purposes of Code sec. 2101(b)(6).**

**(a) Definition of gross receipts.**—The term “gross receipts” means the total receipts from the sale, lease or rental of property held primarily for sale, lease, or rental in the ordinary course of trade or business, and gross income from all other sources.

**(b) Example.**—A person described in Reg. § 2101(a)-1(c)(3) had gross receipts of \$70,000,000 in 2009 from the sale of personal property manufactured in Puerto Rico. The person also had gross receipts of \$10,000,000 from the sale of personal property not manufactured in Puerto Rico and has \$6,000,000 of gross interest income. The person had gross receipts of \$86,000,000 for 2009.

**Reg. § 2101(d)-1. Application of ten (10) percent tests in Code sec. 2101(c).**

**(a) Ten (10) percent requirement.**—Code sec. 2101 applies only where the person acquiring personal property or services as defined in Reg. § 2101(a)-1(c) acquires such personal property



or services directly or indirectly from a member of such person's controlled group, or where a person providing distribution or facilitation services for or on behalf of another member of the same controlled group, including services on a commission or commissionaire basis, provides such services that account for

- (1) at least ten (10) percent of the total gross receipts of such other member from the sale of personal property manufactured or produced, and services performed, in Puerto Rico by such other member during any of the three (3) preceding common taxable years,
- (2) at least ten (10) percent, by cost, of the total amount of personal property and services acquired by such person during any of the three (3) preceding common taxable years,
- (3) at least ten (10) percent of the total amount of commissions or other fees earned by such person during any of the three (3) preceding common taxable years; or
- (4) in the case of transactions facilitated by the taxpayer, such transactions, together with the activities in Code sec. 2101(c)(1)(A), (B), and (C), account for at least ten (10) percent of the total gross receipts of such other member or at least ten (10) percent of the total gross receipts of the taxpayer from facilitation services for any of the three (3) preceding common taxable years.

(b) In the case of any acquisition that involves the transfer of personal property between places of storage, processing, sales or marketing that are owned or operated by the same corporation, partnership, or proprietorship where such places are in separate municipalities or other geographic locations inside or outside Puerto Rico, the ten (10) percent requirement in paragraph (a) shall be deemed satisfied.

(c) If a person has not been in existence for each of the three (3) preceding common taxable years, a determination of gross receipts, costs, commissions, fees, and gross receipts from facilitation services shall be determined based on the amounts derived, paid or incurred during the person's period of existence.

**Reg. § 2101(d)-2. Anti-Abuse Rule.**

(a) **General Rule.**—There shall be disregarded any transaction, or series of transactions, one of the principal purposes of which is the avoidance of the tax imposed under Code sec. 2101, including, without limitation, the organization or use of corporations, partnerships, or other entities or the use of commission or commissionaire arrangements (including facilitation arrangements), or the use of any other plan or arrangement, and there shall be disregarded the use



of any non arm's length charges for personal property or services. Avoidance for purposes of Code sec. 2101(c)(2) includes reduction of the excise tax described in Code sec. 2101 by any means, including, but not limited to, affecting whether or not transactions are effected between members of the same controlled group, affecting the amount or value of property that is subject to the excise tax, affecting the operation of the ten (10) percent test described in Code sec. 2101(c) or affecting the operation of the gross receipts test described in Code sec. 2101(b)(1).

**(b) Presumption.**—Any transaction, or series of transactions, that occurs after October 25, 2010, and which has the effect of significantly reducing a taxpayer's liability for the excise tax imposed under Code sec. 2101, or which has the effect of delaying imposition of a significant amount of such excise tax, shall be treated as having as a principal purpose the avoidance of Code sec. 2101, unless the taxpayer establishes the contrary to the satisfaction of the Secretary by clear and convincing evidence. For purposes of the preceding sentence, a change in procedures for processing or handling property that has, or may have, the effect of removing purchases of such property from the coverage of Code sec. 2101 shall constitute a series of transactions.

**(c) Non arm's length charges.**—For purposes of Code sec. 2101(c)(2), a non arm's length charge shall mean:

(1) in the case of a taxable acquisition, a price other than the price determined in accordance with the rules of Reg. § 2101(b)-2(a).

(2) in the case of any other transaction, a price other than the price determined in accordance with the rules of Reg. § 1047-1.

**(d) Examples.**—

*Example 1.* Company A engages in manufacturing and production in Puerto Rico. In 2010, Company A has gross receipts of \$100,000,000. As of December 31, 2010, Company A contributes a business to a newly formed wholly-owned subsidiary, Company S. In 2011, both Company S and Company A have gross receipts of \$50,000,000. Because the transfer of the business on December 31, 2010 would have the effect of reducing the tax imposed under Code sec. 2101 on acquisitions by other members of the controlled group (as to which the requirements of Reg. § 2101(d)-1 are otherwise met) from the business formerly conducted by Company A, the formation of Company S will be disregarded, unless Company A and Company S can demonstrate to the satisfaction of the Secretary by clear and convincing evidence that the avoidance of Code sec. 2101 was not a principal purpose of the transaction. Even if Company A and Company S are able to demonstrate that the transaction did not have a principal purpose of avoidance of Code sec. 2101, acquisitions by members of the controlled group (as to which the requirements of Reg. § 2101(d)-1 are otherwise met) from Company A in 2011 would be subject



to tax under Code sec. 2101 because Company A had gross receipts in excess of \$75,000,000 for one of the three (3) preceding taxable years.

*Example 2.* Manufactco and Purchaser are members of the same controlled group. Prior to October 25, 2010, Manufactco engaged in activities that included receiving separately the eight components of Product A, combining the components into units of Product A through a manufacturing process that is more extensive than mere assembly, and then packaging Product A for sale to Purchaser. On a date after October 25, 2010, Manufactco's procedures change so that it receives Product A already assembled and then merely packages Product A for transportation and sale to Purchaser A. The liabilities of Purchaser A for the excise tax under Code sec. 2101 would decrease if the change in procedures were respected and not disregarded. The change in procedure will be disregarded for purposes of the excise tax, unless the purchaser establishes to the satisfaction of the Secretary, by clear and convincing evidence, that the change did not have as a principal purpose the avoidance of the tax imposed under Code sec. 2101.

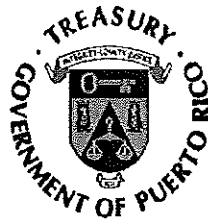
*Example 3.* Prior to October 25, 2010, Purchaser B, a member of the Group A controlled group within the meaning of Reg. § 2101(c)-1, purchased Product B from Seller, a member of Group A that performs manufacturing operations in Puerto Rico. After October 25, 2010, members of Group A arrange for Product B to be purchased by New Purchaser, a company that is not part of Group A but engages in transactions involving Product B with members of Group A. The liabilities of Purchaser for the excise tax under Code sec. 2101 would decrease if the change in procedures were respected and not disregarded. The change in procedure will be disregarded for purposes of the excise tax, unless Group A establishes to the satisfaction of the Secretary, by clear and convincing evidence, that the change did not have as a principal purpose the avoidance of the tax imposed under Code sec. 2101.

#### **Reg. § 2102(a)-1. Collection and Deposit of Tax.**

**(a) General Rule.**—Each person entitled to receive consideration for personal property or services in a transaction on which a tax is imposed by Code sec. 2101(a) shall collect the tax computed under this Subtitle B from the person providing or to provide such consideration and deposit, in the manner prescribed by the Secretary (which may include depositing by electronic means), with the Secretary or any institution authorized by the Secretary to be a depository of public funds on or before the fifteenth (15<sup>th</sup>) day of the month following the month in which the acquisition occurs.

#### **(b) Examples.**—

*Example 1.* Company B acquires property subject to tax under Code sec. 2101 from Company A on December 1, 2011 for \$100 (without regard to the excise tax under Code sec. 2101). Under the contract between Company A and Company B, Company B paid



Company A \$50 on January 15, 2011 and \$50 on December 15, 2011. Company A must collect and deposit \$4 (the excise tax with respect to the acquisition for a price of \$100) on or before January 15, 2012, the fifteenth day following the month in which the acquisition occurs (December).

*Example 2.* Company B acquires property subject to tax under Code sec. 2101 from Company A on January 15, 2011 for \$100 (without regard to the excise tax under Code sec. 2101). Under the contract between Company A and Company B, Company B pays Company A \$100 on December 15, 2010. Company A must collect and deposit \$4 (the excise tax with respect to the acquisition for \$100) on or before February 15, 2011, the fifteenth day following the month in which the acquisition occurs (January).

*Example 3.* Company B acquires property subject to tax under Code sec. 2101 from Company A on January 15, 2011 for \$100 (without regard to the excise tax under Code sec. 2101). Under the contract between Company A and Company B, Company B is to pay Company A the acquisition price by March 15, 2011. Company A must collect and deposit \$4 (the excise tax with respect to the acquisition for \$100) on or before February 15, 2011, the fifteenth day following the month in which the acquisition occurs (January).

*Example 4.* The facts are the same as Example 3 except that Company B acquires the property on January 15, 2012. Company A must collect and deposit \$3.75 (the excise tax with respect to the acquisition for \$100) on or before February 15, 2012, the fifteenth day following the month in which the acquisition occurs (January).

#### **Reg. § 2102(a)-2. Generally Applicable Credits Against Tax.**

**(a) In General.** A person otherwise liable for the excise tax imposed by Code sec. 2101, may reduce the liability for such tax, but not below zero, by applying the credits described in paragraphs (b) through (h) below. The credits in paragraphs (b) through (h) of this article shall apply on a controlled group basis. Except as otherwise provided in this article, the amount of the credit in each of paragraphs (b) through (h) shall be allocated among all members of the controlled group that make acquisitions subject to tax under Code sec. 2101 (each an “acquiring member”) according to their respective taxable acquisitions computed on a cumulative basis during the calendar year as of the end of each calendar month. Consistent with the requirement that the excise tax imposed by Code sec. 2101 applies for the calendar year, the credits permitted under this article are computed on a calendar year basis for a controlled group regardless of the common taxable year of the controlled group.



**(b) General Credit against tax.—**

(1) For 2011, each controlled group shall be entitled to a credit of four million (4,000,000) dollars against the tax imposed by Code sec. 2101, or the aggregate tax liability of the controlled group, whichever is less.

(2) For each year after 2011, the maximum amount of the credit under this paragraph (b) shall equal the excise tax rate for such year divided by four (4) percent (the excise tax rate for 2011) times four million (4,000,000) dollars.

(3) Except as otherwise provided in subparagraph (4), the credit under this paragraph (b) that may be used for any calendar month may not exceed the amount of the annual credit under subparagraph (1) or (2) divided by twelve.

(4) If a controlled group reasonably projects that, after the application of the credit described in this paragraph (b), the sum of the liabilities for all acquiring members of the controlled group for the excise tax imposed by Code sec. 2101 will be zero for the calendar year, then no acquiring member shall be required to pay the excise tax for any calendar month for which such projections remain reasonable and no member of the controlled group disposing of property subject to tax under Code sec. 2101 (a “disposing member”) shall be required to collect and deposit any such tax for any such month.

(5) No unused credit for the calendar year may be carried forward or carried back, nor shall it be refunded. Notwithstanding the foregoing, if an acquiring member of a controlled group has paid excise tax in one or more months of a calendar year in which the sum of the liabilities for all acquiring members of the controlled group for the excise tax in Code sec. 2101 is zero (without regard to the limitation in subparagraph (3)) for the calendar year after the application of the credit in this paragraph (b), the acquiring member or members shall be entitled to a refund of such tax paid for the calendar year. A claim for refund must be submitted in accordance with the terms and conditions of Code sec. 6011.

(6) If a controlled group claims the credit provided for by this paragraph (b), the controlled group shall reasonably project for the entire calendar year the number of full-time employees employed in manufacturing or producing personal property, or manufacturing services, in Puerto Rico, and such projections shall be attached to each quarterly return of tax, provided, however, that final calculations shall be attached to the quarterly return for the period from October 1 through December 31 for each year for which any credit is claimed. If for a calendar year the controlled group is not in fact eligible for the credit provided by this paragraph (b), the amount of any credit previously claimed for such calendar year shall be treated as a tax arising on account of an acquisition deemed to occur during the month of December of such year.



**(c) Alternative Credit Based on Gross Receipts.—**

(1) In lieu of the credit provided by paragraph (b), a controlled group that meets the requirements described in this paragraph (c) may elect the credit provided by this paragraph (c).

(2) Where, for those members of a controlled group that engage in manufacturing and production in Puerto Rico, the quotient of

(i) the gross receipts with respect to manufacturing and production in Puerto Rico of such members divided by

(ii) the average monthly number of full-time employees in Puerto Rico of such members

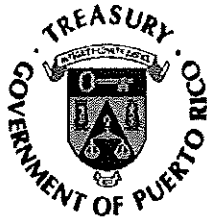
is less than five hundred thousand (500,000) dollars, for 2011 a credit against the tax imposed by Code sec. 2101 of seven million (7,000,000) dollars or the aggregate tax liability of the controlled group, whichever is less, shall be allowed.

(3) For each year after 2011, the maximum amount of the credit shall equal the excise tax rate for such year divided by four (4) percent (the excise tax rate for 2011) times seven million (7,000,000) dollars.

(4) Except as otherwise provided in subparagraph (5), the credit in this paragraph (c) used for any calendar month may not exceed the amount of the annual credit divided by twelve.

(5) If a controlled group reasonably projects that, after the application of the credit described in this paragraph (c), the sum of the liabilities for all acquiring members of the controlled group for the excise tax in Code sec. 2101 will be zero for the calendar year, then no acquiring member shall be required to pay the excise tax for any calendar month for which such projections remain reasonable and no disposing member of the controlled group shall be required to collect and deposit any such tax for any such month.

(6) No unused credit for the calendar year may be carried forward or carried back, nor shall it be refunded. Notwithstanding the foregoing, if an acquiring member of a controlled group has paid excise tax in one or more months of a calendar year in which the sum of the liabilities for all acquiring members of the controlled group for the excise tax in Code sec. 2101 is zero (without regard to the limitation in subparagraph (4)) for the calendar year after the application of the credit in this paragraph (c), the acquiring member or members shall be entitled to a refund of such tax paid for the calendar year.



A claim for refund must be submitted in accordance to the terms and conditions of Code sec. 6011.

(7) If a controlled group elects the use of the credit described in this paragraph (c), the controlled group shall reasonably project for the entire calendar year the number of full-time employees employed in manufacturing or producing personal property, or manufacturing services, in Puerto Rico and the gross receipts for all sales of personal property and services, and such projections shall be attached to each quarterly return of tax, provided, however, that final calculations shall be attached to the quarterly return for the period from October 1 through December 31 for each year for which any credit is claimed. If for a calendar year the controlled group is not in fact eligible for the credit provided by this paragraph (c) because the gross receipts per employee exceed five hundred thousand (500,000) dollars, any credit claimed in excess of the credit allowable under paragraph (b) shall be treated as a tax arising on account of an acquisition deemed to occur during the month of December of such year.

**(d) Alternative Credit Where Taxable Acquisitions Exceed Certain Thresholds.—**

(1) In lieu of the credits provided in paragraphs (b) and (c), a controlled group having, for a calendar year,

(i) taxable acquisitions equal to or greater than four billion (4,000,000,000) dollars,

(ii) an average monthly number of employees engaged in manufacturing and production and manufacturing services in Puerto Rico that equals or exceeds five hundred (500) and

(iii) a total payroll for such employees that equals or exceeds twenty million (20,000,000) dollars

may elect the credit provided by this paragraph (d).

(2) For 2011,

(i) where the taxable acquisitions for all members of the controlled group are equal to or greater than four billion (4,000,000,000) dollars and less than four and one half billion (4,500,000,000) dollars, the credit is twenty million (20,000,000) dollars;

(ii) where the taxable acquisitions for all members of the controlled group are equal to or greater than four and one half billion (4,500,000,000) dollars and less





than five billion (5,000,000,000) dollars, the credit is forty million (40,000,000) dollars;

(iii) where the taxable acquisitions for all members of the controlled group are equal to or greater than five billion (5,000,000,000) dollars and less than five and one half billion (5,500,000,000) dollars, the credit is sixty million (60,000,000) dollars;

(iv) where the taxable acquisitions for all members of the controlled group are equal to or greater than five and one half billion (5,500,000,000), the credit is eighty million (80,000,000) dollars.

(3) For each year after 2011, the credit described in this paragraph (d) shall equal the excise tax rate for such year divided by four (4) percent (the excise tax rate for 2011) times the credit determined under subparagraph (d)(2).

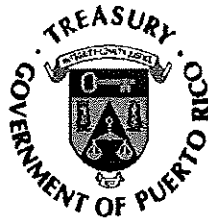
(4) The credit in this paragraph (d) used for any calendar month may not exceed the amount of the annual credit divided by twelve.

(5) No unused credit for the calendar year may be carried forward or carried back, nor shall it be refunded.

(6) If a controlled group elects the use of the credit provided for by this paragraph (d), the controlled group shall reasonably project for the entire calendar year the number of full-time employees employed, and the payroll related thereto, in manufacturing or producing personal property, or manufacturing services, in Puerto Rico and the gross receipts for all sales of personal property and services, and such projections shall be attached to each quarterly return of tax, provided, however, that final calculations shall be attached to the quarterly return for the period from October 1 through December 31 for each year for which any credit is claimed. If for the calendar year the controlled group is not in fact eligible for the credit provided by this paragraph (d), or is eligible for a lesser amount than the amount claimed, any credit claimed in excess of the credit allowable under paragraph (b), (c) or (d), as the case may be, shall be treated as a tax arising on account of an acquisition deemed to occur during the month of December of such year.

**(e) Addition to Alternative Credit For Incremental Increase in Employees**

(1) In the case of a controlled group that meets the requirements of subparagraph (d)(1) for a taxable year, and meets the requirements in this paragraph (e), an additional credit is allowed as provided in this paragraph (e).



(2) For each calendar month for which the number of employees employed by the controlled group in connection with manufacturing and production and manufacturing services in Puerto Rico is in excess of the employee baseline for the controlled group (as defined in subparagraph (i)(1)) by at least one hundred (100) employees, the controlled group shall be entitled to a credit of the following amount:

(i) where the number of employees in excess of the employee baseline is at least one hundred (100) but less than two hundred (200), the credit is seven hundred and fifty thousand (750,000) dollars;

(ii) where the number of employees in excess of the employee baseline is at least two hundred (200) but less than three hundred (300), the credit is one million five hundred thousand (1,500,000) dollars;

(iii) where the number of employees in excess of the employee baseline is at least three hundred (300) but less than four hundred (400), the credit is two million two hundred fifty thousand (2,250,000) dollars;

(iv) where the number of employees in excess of the employee baseline is at least four hundred (400) but less than five hundred (500), the credit is three million (3,000,000) dollars; and

(v) where the number of employees in excess of the employee baseline is at least five hundred (500), the credit is three million seven hundred fifty thousand (3,750,000) dollars.

(3) For years after 2011, the credit described in this paragraph (e) shall equal the excise tax rate for such year divided by four (4) percent (the excise tax rate for 2011) times the credit determined under subparagraph (e)(2).

(4) No unused credit for the calendar year may be carried forward or carried back, nor shall it be refunded.

(5) If a controlled group elects the use of the credit provided for by this paragraph (e), the controlled group shall reasonably project for the entire calendar year the number of full-time employees employed in manufacturing or producing personal property, or manufacturing services, in Puerto Rico and the gross receipts for all sales of personal property and services, and such projections shall be attached to each quarterly return of tax, provided, however, that final calculations shall be attached to the quarterly return for the period from October 1 through December 31 for each year for which any credit is claimed. If a controlled group claims the credit provided for by this paragraph (e) and the controlled group is not in fact eligible for the credit provided by this paragraph (e), or is



eligible for a lesser amount than the amount claimed, any credit claimed in excess of the credit allowable under paragraph (e), as the case may be, shall be treated as a tax arising on account of an acquisition deemed to occur during the month of December of such year.

**(f) Controlled Groups with Manufacturing and Production Facilities in Multiple Municipalities in Puerto Rico.—**

- (1) In lieu of the credits provided in paragraphs (d) and (e) (but in addition to any credit provided by paragraph (b) or paragraph (c)), a controlled group that meets the requirements in this paragraph (f) below may elect the credit provided by this paragraph (f).
- (2) In the case of a controlled group that has members that are engaged in manufacturing and production or manufacturing services in facilities located in three or more different municipalities in Puerto Rico as of October 24, 2010, a credit of three million (3,000,000) dollars per municipality shall be allowed for each such facility that has a monthly average of more than fifty (50) employees during the calendar year for which a credit is claimed under this paragraph (f), up to a maximum credit of fifteen million (15,000,000) dollars.
- (3) For each year after 2011, the credit described in this paragraph (f) shall equal the excise tax rate for such year divided by four (4) percent (the excise tax rate for 2011) times the credit allowed under subparagraph (f)(2).
- (4) The credit in this paragraph (f) used for any calendar month may not exceed the amount of the annual credit divided by twelve.
- (5) No unused credit for the calendar year may be carried forward or carried back, nor shall it be refunded.
- (6) If a controlled group elects the use of the credit provided for by this paragraph (f), the controlled group shall reasonably determine that it will maintain the required number of facilities and employees for the entire calendar year, and a certification of such determination shall be attached to each quarterly return of tax. If the controlled group is not in fact eligible for the credit provided by this paragraph (f), or is eligible for an amount less than the amount claimed, any credit claimed in excess of the credit allowable under this paragraph (f) shall be treated as a tax arising on account of an acquisition deemed to occur during the month of December of such year.



**(g) Minority Suppliers.—**

(1) Where a controlled group makes direct purchases of goods or services from a supplier certified by the Secretary and by the Department of Economic Development and Commerce as a minority business (“Minority Supplier”), then a credit shall be allowed as described in this paragraph (g).

**(2) Amount of Credit.—**

(i) Where a controlled group makes direct purchases of goods and services from Minority Suppliers that are less than or equal to seventy-five (75) percent of its total purchases of goods and services, and such purchases are in excess of the average annual direct purchases of goods and services from Minority Suppliers for the preceding two (2) calendar years, then a credit in the amount of one hundred (100) percent of such excess shall be allowed.

(ii) Where a controlled group makes direct purchases of goods and services from Minority Suppliers in excess of seventy-five (75) percent of its total purchases of goods and services, then a credit in the amount of one hundred fifty (150) percent of such excess shall be allowed.

(3) The credit allowed by this paragraph (g) is in addition to, and not in lieu of, the credits provided for in paragraphs (b), (c), (d), (e), (f), and (h).

(4) The credit provided for in this paragraph (g) may not exceed one (1) percent of the excise tax otherwise owing (after the application of any other credits).

(5) If a controlled group claims the benefits of the credit described in this paragraph (g), the controlled group shall reasonably project for the entire calendar year the purchase of goods and services from Minority Suppliers, provided, however, that final calculations shall be attached to the quarterly return for the period from October 1 through December 31 for each year for which any credit is claimed. If the controlled group is not in fact eligible for the credit provided by this paragraph (g), or is eligible for a lesser amount than the amount claimed, any credit claimed in excess of the credit allowable under paragraph (g) shall be treated as a tax arising on account of an acquisition deemed to occur during the month of December of such year.

**(h) Knowledge Corridor and Research and Development Investment Credit.—**

(1) Where a controlled group makes contributions to the Puerto Rico Science, Technology and Research Trust or Special Economic Development Fund or otherwise



invests in research and development activities in Puerto Rico, then a credit shall be allowed as described in this paragraph (h).

**(2) Amount of Credit.—**

(i) Where a controlled group makes contributions to the Puerto Rico Science, Technology and Research Trust or Special Economic Development Fund, there shall be allowed a credit in the amount of 100 percent of such contributions, subject to the limitation that the amount of the credit for such contributions may not exceed one (1) percent of the excise tax otherwise owing after the application of any applicable credits in paragraphs (b), (c), (d), (e), (f), and (g).

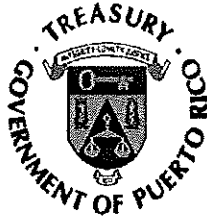
(ii) Where the amount of a controlled group's research and development investments in Puerto Rico in a calendar year is in excess of the average annual research and development investments in Puerto Rico for the preceding two (2) calendar years, then a credit in the amount of 100 percent of such excess shall be allowed, subject to the limitation that the amount of the credit attributable to such excess may not exceed two (2) percent of the excise tax otherwise owing after the application of any applicable credits in paragraphs (b), (c), (d), (e), (f), and (g).

(3) The credit allowed by this paragraph (h) is in addition to, and not in lieu of, the credits provided for in paragraphs (b), (c), (d), (e), (f), and (g).

(4) A controlled group shall adequately document the contributions or investments prior to claiming any credit under this paragraph (h). The controlled group may reasonably project its tax liability for the entire calendar year and reduce such reasonably projected tax liability by the sum of the contributions qualifying for the credit described in subdivision (h)(2)(i) (not to exceed one (1) percent of the projected tax liability for each quarter) and the incremental research and development investments qualifying for the credit described in subdivision (h)(2)(ii) (not to exceed two (2) percent of the projected tax liability for each quarter), provided, however, that final calculations shall be attached to the quarterly return for the period from October 1 through December 31 for each year for which any credit is claimed. If the controlled group is not in fact eligible for a credit provided by this paragraph (h), or is eligible for a lesser amount than the amount claimed, any credit claimed in excess of the credit allowable under this paragraph (h) shall be treated as a tax arising on account of an acquisition deemed to occur during the month of December of such year.

**(i) Definitions and Special Rules.—**

**(1) Employee Baseline Defined.—**For purposes of this article, the employee baseline for a controlled group shall be the average monthly number of full-time employees engaged



in manufacture and production or manufacturing services in Puerto Rico for the twelve months ended October 1, 2010.

(i) Where a controlled group can demonstrate by clear and convincing evidence that its worldwide employment has decreased, the Secretary, upon consultation and agreement with the Secretary of Economic Development, may decrease the employee baseline by a percentage not in excess of the percentage by which worldwide employment of the controlled group has decreased.

(ii) In the case of acquisitions or dispositions of trades or businesses, the Secretary, upon consultation and agreement with the Secretary of Economic Development, may determine appropriate adjustments to the employee baselines of the acquiring and disposing controlled groups.

(iii) **Exceptional circumstances.**—In the case of exceptional circumstances, the Secretary, upon consultation and agreement with the Secretary of Economic Development, may determine appropriate adjustments to the employee baseline of a controlled group. Such circumstances could include destruction of, or damage to, a facility by a hurricane or other disaster, but would not include the expiration of a patent.

(2) **Limitation on Availability of Credits.**—No credit shall be permitted under this Reg. § 2102(a)-2 to any member of a controlled group for a calendar year in which the controlled group has an average monthly number of full-time employees engaged in manufacture and production and manufacturing services in Puerto Rico for the twelve months for such calendar year that is less than ninety (90) percent of the controlled group's employee baseline.

### **Reg. § 2102(a)-3. Maximum Tax.**

(a) **In General.**—Except as provided in paragraph (c), in the aggregate, the tax imposed by Code sec. 2101 for a calendar year on all of the members of a controlled group that make taxable acquisitions shall not exceed three hundred seventy-five million (375,000,000) dollars less the Minority Suppliers credit provided in paragraph (g) and the Knowledge Corridor and Research and Development Investment credit provided in paragraph (h).

(b) **Computation.**—Pursuant to paragraph (a), the tax imposed by Code sec. 2101 shall be the lesser of:

(1) the amount of the tax computed after the application of the credits available in paragraphs (b), (c), (d), (e), (f), (g), or (h) or



(2) three hundred and seventy-five million (375,000,000) dollars less the minority suppliers credit provided in paragraph (g) and the Knowledge Corridor credit provided in paragraph (h).

**(c) Limitation on Application of Maximum Tax.**—The maximum tax limitation in paragraphs (a) and (b) shall not apply to a controlled group for a calendar year in which the controlled group has an average monthly number of full-time employees engaged in manufacture and production and manufacturing services in Puerto Rico for the twelve months for such calendar year that is less than ninety (90) percent of the controlled group’s employee baseline as defined in Reg. § 2102(a)-2(i)(1).

**Reg. § 2103(a)-1. Filing of Returns.**

**(a)** Regardless of any common taxable year, each person that is required to collect the tax imposed by Code sec. 2101(a) shall be required to be included in a tax return for each calendar quarter on April 30, July 31, October 31, and January 31 and pay with the return that part of the tax that has not been paid or deposited in accordance with Code sec. 2102(b). The return shall be filed in the form established by the Secretary (which may include electronic filing) and shall contain the information set forth in these regulations and in the instructions to the form.

**(b)** Unless otherwise provided for by the Secretary, each controlled group shall file a single quarterly return setting forth the name and taxpayer identification number of each member of the controlled group. Such return shall separately state the taxable acquisitions of each member of such controlled group, the amount of tax deposited with respect to such taxable acquisitions, the tax owing with respect to such taxable acquisitions, the amount of tax paid with the return, any credits under Reg. § 2102(a)-2 (including all information necessary to support such credits), any transfer pricing adjustments under Reg. § 2101(b)-2(a)(5) properly allocable to such acquiring member, and such other information as the Secretary may prescribe.

**Reg. § 2104(a)-1. Credit for Certain Taxes Paid in Code sec. 2104.**

**(a) Definition of taxes for purposes of Code sec. 2104.**—“Taxes,” within the meaning of Code sec. 2104(a)(1), shall include taxes of any kind imposed by a state or territory of the United States, including but not limited to excise taxes, the liability for which accrues solely as a result of the acquisition of personal property and services described in Code sec. 2101(b)(1).

**(b) Prevention of multiple taxation.**—If a member of a controlled group pays an excise tax (the “first tax”) under Code sec. 2101 with respect to a transaction involving tangible property,



and the same member or another member of the same controlled group pays an additional excise tax under Code sec. 2101 or another tax within the meaning of Code sec. 2104(a)(1) (the "second tax") to a state or territory of the United States, including Puerto Rico, in an amount greater than the first tax, with respect to the acquisition of the same tangible property, then, except as provided in the following sentence of this paragraph (b), the member that paid the first tax shall be entitled to reduce its excise tax in the amount of the first tax at the time of the payment of the second tax. If, because of a decline in the value of property or differences in the applicable tax rate, the amount of the second tax is less than that of the first tax, then the reduction that is described in this paragraph (b) shall be limited to the amount of the second tax. If an exemption or credit is available for the second tax, the reduction allowable under this paragraph (b) shall be reduced by the amount of the exemption or credit allowed or allowable.

**(c) Examples.—**

*Example 1.* Companies A, B, and C are members of the same controlled group. Company B purchases from Company A property subject to tax under Code sec. 2101 for \$100. Company B pays \$4 in excise tax with respect to such goods under Code sec. 2101. Company B does not engage in manufacturing or production through its own employees or contractors in Puerto Rico. Company B sells the same goods to Company C for \$105. Company C is not subject to the excise tax under Code sec. 2101 on the acquisition from Company B because Company B does not engage in manufacturing or production through its own employee or contractors in Puerto Rico.

*Example 2.* Companies A, B, and C are members of the same controlled group. Company B engages in manufacturing or production through its own employees or contractors in Puerto Rico. Company B purchases from Company A semi-finished goods subject to tax under Code sec. 2101 for \$100. There is a tentative excise tax of \$4 with respect to such goods under Code sec. 2101.

Company B further processes the semi-finished goods in Puerto Rico in a manner that constitutes production and manufacturing and sells the goods back to Company A still in unfinished form for \$125, for further processing. There is a tentative excise tax of \$5 with respect to such goods under Code sec. 2101. The tentative excise tax of \$4 with respect to the acquisition by Company B is eliminated.

Company A further manufacturers or produces the goods in Puerto Rico and then sells the finished goods to Company C for \$200. Company C pays \$8 in excise tax with respect to such goods under Code sec. 2101. The tentative excise tax of \$5 with respect to the acquisition by Company A is eliminated.





*Example 3.* The facts are the same as in Example 2, except that Company C is subject to a sales tax of \$2 in state Q of the United States with respect to the acquisition of the same goods that Company C acquired from Company A. Company C may reduce its excise tax by \$2. If Company C could, but does not, avail itself of a purchase for resale or other similar exemption for the state Q sales tax, Company C would not be entitled to reduce its excise tax by \$2.