

Tax Alert: Transfer pricing and Act 20 transition to Puerto Rico

While we are all in agreement that Act No. 20 of 2012, known as the Act to promote the exportation of services, provides attractive tax incentives for companies that establish and expand their export services business in the island, we tend to focus on the 4% flat corporate tax rate, 100% tax exemption on dividends or profit distributions, etc., and forget the full set of implications that come with relocating all or part of a business to a different jurisdiction.

One of the most common difficulties arises because most companies considering the benefits of Act 20 are already setup and fully functional in their home jurisdiction, and the relocation does not occur all at once, leaving some functions at the home office level, which eventually translates into intercompany charges between both entities.

This is where the planning phase becomes crucial. If these allocations are totally or partially disallowed by any of the jurisdictions involved, this can undermine your strategy and your expected tax savings and/or benefits, leaving you to question the cost effectiveness of the relocation in the first place. In addition, there may be some issues related to the transfer of intangibles.

One way to help mitigate such risks is through a **transfer pricing study**.

transfer pricing rules and regulations vary from country to country, but most are based on the Organization for Economic Co-operation and Development (OECD) guidelines and principles.

Multinational companies have gone through increased scrutiny recently in Puerto Rico, mainly due to Treasury's presumption that big companies doing business in Puerto Rico have been transferring unreasonable costs to the island in an attempt to lower their profits and therefore reduce their Puerto Rico tax liabilities.

First off, let's start by stating that Puerto Rico's current transfer pricing policy is fairly vague to say the least. However, due to the increased scrutiny, the island may have no choice but to re-evaluate its current rules and formalize a valid transfer pricing policy shortly.

A **transfer pricing study's** driving force is the "arm's length principle", which effectively confirms if the transactions conducted between related parties are consistent with third party transactions, under the same sets of circumstances.

For companies under Act 20, these intercompany transactions will become a focal point of interest to both jurisdictions involved, but mainly to the non-Puerto Rico jurisdiction.



Contact us

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Through the **Kevane Grant Thornton business and tax application for mobile devices** you will have access to our Alerts, Tax News and other related matters, plus a customized tax calendar for individuals, businesses and other entities, thus providing an excellent tool to manage filing and payment due dates with government agencies in Puerto Rico.

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Since the Puerto Rico income will be taxed at a 4% flat rate, the foreign tax authorities will worry about the shifting of income to our jurisdiction in order to reduce the non-Puerto Rico income in other jurisdictions, which is being taxed at regular rates.

Under this scenario, the Puerto Rico Treasury will probably not have an issue with the intercompany allocations. The other side, however, will of course want to claim their fair share of income. Unless you are able to prove that the aforementioned transactions were conducted in accordance with the “arm’s length principle”, a transfer pricing adjustment could be made to your return. Interest, surcharges and penalties will accrue on any unpaid balance of the tax liability.

A **transfer pricing study** is a multi-functional tool. It can provide guidance as to how the market is doing, it can help establish mark-up rates for services or goods provided and can serve as evidence of “arm’s length principle” in an audit or investigation procedure by a governing jurisdiction.

Kevane Grant Thornton, in addition to assisting you with the planning, implementation and acquisition of an Act 20 Tax Grant, we are fully capable of assisting you with the preparation of a **transfer pricing study** in full compliance with the rules and regulations of participating jurisdictions.

Please contact our Tax Department should you require additional information regarding this or any other tax issue. We will be glad to assist you.

