GOVERNMENT OF PUERTO RICO
DEPARTMENT OF THE TREASURY

Regulation to implement the provisions of Section 2101, 2102, 2103 and 2104 of Act No. 120 of October 31, 1994, as amended, known as the "Puerto Rico Internal Revenue Code of 1994", enacted pursuant to Section 6130 of the Internal Revenue Code of 1994, as amended, which authorizes the Secretary of the Treasury to adopt the Regulations necessary to make effective said Code.

Reg. 2101(a)-1

"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 is 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 (i) 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 in Puerto Rico, and (ii) 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) Tangible property will be treated as having been manufactured or produced in whole or in part in Puerto Rico by a person where such person satisfies one

or more of the provisions of subdivision (i), (ii), or (iii) below with respect to such property.

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

(ii) Other manufacture of tangible property.— Such person's employees or contractors perform physical activities in Puerto Rico with respect to such property 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 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 are substantial in nature depends 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) In no event will activities that do not occur in Puerto Rico constitute the manufacture or production of tangible property in Puerto Rico for purposes of Code sec. 2101. Notwithstanding anything to the contrary in subparagraph (c)(3), in no event will property physically manufactured in whole outside of Puerto Rico be considered tangible property manufactured or produced in whole or in part in Puerto Rico for purposes of Code Sec. 2101.

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

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

(7) 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) that is manufactured or produced in Puerto Rico within the meaning of this paragraph (c), 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.

(8) A person will be treated as performing services in Puerto Rico in connection with the manufacturing or production of tangible property only if such person performs services in Puerto Rico that are related to tangible property that is located in Puerto Rico and that is manufactured or produced in whole or in part in Puerto Rico within the meaning of subparagraphs (c)(3) through (c)(7) above at the time such services are performed ("manufacturing services").

(d) Examples.—

Example 1. 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. The activities of Pharmco in Puerto Rico in connection with Products A, B, C and D are treated as manufacturing or production by such person's employees or contractors in Puerto Rico under a concession issued under Act No. 73 of May 28, 2008, as amended. 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.

Example 2. Company S performs management services in Puerto Rico with respect to manufacturing and production activities carried out in Country C related to property located in Country C. The management services include quality assurance, quality control, oversight and direction, supply chain management, logistics, material selection, and other similar functions, none of which involve transformation of the property in Puerto Rico. The property is physically manufactured in whole in Country C. Company S's activities with respect to such property do not constitute the manufacture or production of property in Puerto Rico and do not constitute services performed in Puerto Rico in connection with the manufacture or production of tangible property in Puerto Rico. This is true whether or not any grant or concession agreement entered into with Puerto Rico by Company S describes Company S's activities with respect to such property as manufacturing or production.

Example 3. The facts are the same as in Example 2, except that the property is transported from Country C to Puerto Rico for finishing. If the finishing activities in Puerto Rico are sufficient to be treated as manufacturing or production in accordance with subparagraph (c)(3), then the property will be treated as having been manufactured or produced in Puerto Rico.

Reg. 2101(b)-1 to 2101(b)-2

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

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

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

regardless of whether such person is located within or outside Puerto Rico.

(2) An acquisition includes any transfer of a computer program by a member of a controlled group from a location in Puerto Rico to another member of the controlled group irrespective of the physical or electronic or other medium used to effectuate such transfer.

(3) 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 physical 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, unless the taxpayer

establishes the contrary to the satisfaction of the Secretary by clear and convincing evidence.

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

(1) Acquisitions described in Code sec. 2101(a)(1) are limited to acquisitions from a person 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.

(d) Examples.—

Example 1. Companies A, B, and C are members of the same controlled group. Company A substantially transforms tangible property through the activities of its employees or contractors in Puerto Rico. Following the substantial transformation, Company A sells the tangible property to Company B. Company B is subject to excise tax with respect to such tangible property 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 tangible property to Company C. 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 employees or contractors in Puerto Rico.

Example 2. Company S, Company T, Company U, and Company V are members of the same controlled group. Company S substantially transforms tangible property through the activities of its employees or contractors in Puerto Rico. Company T substantially transforms other tangible property through the activities of its employees or contractors in Puerto Rico. In 2011, Company U acquires from Company S tangible property that Company S has produced in Puerto Rico. Also in 2011, Company V acquires tangible property from Company T that Company T has produced in Puerto Rico. For the common taxable years of the controlled group ending in 2008, 2009, and 2010, Company S has gross receipts of $40,000,000, $45,000,000, and $50,000,000 respectively. For the same years, Company T has gross receipts of $80,000,000, $85,000,000, and $90,000,000, respectively. Acquisitions by Company V from Company T of property produced by Company T in Puerto Rico are subject to tax under Code sec. 2101. Acquisitions by Company U from Company S of property produced by Company S in Puerto Rico are not subject to tax under Code sec. 2101 because Company S did not have in excess of $75,000,000 of gross receipts in any of the three preceding common taxable years. See, however, Reg. § 2101(d)-2(d), Example 1. If Company U has not acquired any property from another member of the controlled group that had gross receipts in excess of $75,000,000 for any of the three preceding common taxable years, then Company U would be subject to tax under Code sec. 1123(f)(4).

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.—If a bill is rendered to the taxpayer for personal property or services, or both, except as provided in subparagraph (a)(4), the value on which the tax with respect to such personal property or services, or both, shall be based shall be the sum of all charges for such personal property or services, or both, included in the bill. If a

taxpayer acquires personal property or services, or both, in a transaction in which no bill is rendered, the value on which the tax with respect to such personal property or services, or both, shall be based is the fair market value of the personal property or services, or both.

(1) Bill for property or services.—Except as provided in subparagraph (a)(4), 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, is reported, by any member of the controlled group of which the person is a member, to have been acquired from the member disposing of the property ("disposing member") for purposes of determining income tax liabilities under the laws of Puerto Rico or any other jurisdiction that in fact imposes an income tax. If the price reflected in such documentation does not represent a price that is consistent with the fair market value of the personal property or services, then no "bill" for purposes of Code sec. 2101(b)(2) shall be treated as having been rendered.

(2) Fair market value.—Except as provided in subparagraph (a)(4), for purposes of Code sec. 2101(b)(2)(B), the fair market value of property or services, or both, shall be based on the fair market value of such property or services, or both (as defined in Reg. § 2101(a)-1(c)), that has been used by the member of the controlled group that makes the acquisition (the "acquiring member") which is subject to tax under Code sec. 2101 (a "taxable acquisition") or the disposing member which is subject to tax under Code sec. 2101 in determining the price of such product or services for purposes of determining income tax liabilities under the laws of Puerto Rico or any other jurisdiction that in fact imposes a tax on the net income from the sale of the property or services by the acquiring member, provided, however, that, where the acquiring member can demonstrate by clear and convincing evidence that transactions with unrelated parties with respect to the same or substantially similar property or services occurred under similar circumstances (including, but not limited to, comparable sales volumes) at a lower price during the calendar month of the acquisition, then such lower price shall be the fair market value. For purposes of the preceding sentence, if a

member of a controlled group acquires and resells to an unrelated party a significant amount of property without adding substantial value to the property by manufacturing or production, the fair market value of such property shall be determined by reference to the price at which such acquiring member resells such property.

(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 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 an amount that is based on the price of the actively traded commodity obtained from a publicly available source of market data and is evidenced by a contract or an established course of dealing. 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 or before October 24, 2010 had Code sec. 2101 been in effect on such date.

(4) 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 value of property subject to excise tax under Code sec. 2101, 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 the calendar quarter in which the taxable acquisitions of such property occurred (using the applicable percentage for the calendar year in which such quarter occurred

under Code sec. 2101(b)(4)) that is filed within twenty and one half (20½) months following the month of such acquisitions. 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. The amount of any reduction in excise tax paid for a calendar quarter as a result of 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, then (a) the amount of such increased excise tax shall be paid with the amended return for such calendar quarter, and (b) in accordance with Code sec. 6041(a)(1), the payment of the increase in excise tax shall include interest at the rate provided for in Code sec. 6041(a)(1) accruing from the date the tax was required to be deposited through the date the increase in tax and interest is paid with the amended return. Where an adjustment is made to the amount of taxable acquisitions pursuant this subparagraph (a)(5), the amount of any credit available under Reg. § 2102(a)-2 must be recomputed using the adjusted amount of taxable acquisitions. The potential for adjustments under this subparagraph (a)(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 values as otherwise determined under this article.

(6) Returns.—In the case of tangible property that is acquired by a member of a controlled group in a taxable acquisition and is later rejected by the acquiring member and physically returned to the disposing member of the controlled group from which the tangible property was acquired, an adjustment to the amount of taxable acquisitions by the acquiring member shall be allowed in the month during which the rejection and return occurs, provided such rejection and return occurs within twelve (12) months following the month of the taxable acquisition, and further provided that the terms between the acquiring member and the disposing member allow for such

return and provide that the disposing member shall return the consideration (or permit an allowance) as a result of such return and that such return was not contemplated and included in the original price.

(7) Examples.—

Example 1. Company A and Company B are members of the same controlled group. Company A manufactures Product X in Puerto Rico. Company A regularly sells Product X to Company B. Company B sells Product X to unrelated parties in Country Y. Company B reports the acquisition price of Product X from Company A as $100 for Country Y income tax purposes. The quarterly excise tax return filed on behalf of the controlled group that includes Company A and Company B computes the excise tax under Code sec. 2101 with respect to acquisitions of Product X by Company B from Company A by reference to an invoice that reports the acquisition price of Product X as $80. Such invoice is not considered a bill for purposes of subparagraph (a)(1). Therefore, the value of Product X on which the tax under Code sec. 2101 is imposed is the fair market value of Product X. If the invoice instead reported the acquisition price of Product X as $100, consistent with the price reported by Company B to Country Y for income tax purposes, then the invoice would be considered a bill and the tax under Code sec. 2101 would be computed by reference to the amount of that bill.

Example 2. 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 an acquisition price of $100 for Product X in a transaction in June 2010. Company B sells Product X to unrelated Companies C, D, and E in separate comparable 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 property or services occurred at a lower price during

the calendar month of the acquisition, the value of Product X for acquisitions occurring in January 2011 for purposes of Code sec. 2101 may be lower than $100.

Example 3. Company A has manufactured Product X in Puerto Rico since a time before October 25, 2010. 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 then-current market value for precious metal D. 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 unrelated customer is reflected in an order acknowledgment or other evidence of an established course of dealing and is based on and would fluctuate with 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 4. 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 with 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.

Example 5. Company K and Company L are members of the same controlled group. Company K produces Product F through the activities of its employees and contractors in Puerto Rico. Company L acquires Product F from Company K, and Company L then distributes Product F to unrelated parties. The price paid by Company L to Company K for Product F is $95. Company L distributes Product F in Country C to unrelated parties at a price of $100. For purposes of determining the

fair market value of Product F, a price of $95 would be regarded as a price determined by reference to a price at which an acquiring member resells Product F.

(b) Value Determined at Time of Acquisition.—The value of personal property or services shall be determined at the time of the acquisition of such personal property or services determined in accordance with Reg. § 2101(b)-1(b). The value of any foreign currency is determined on the date of the acquisition. Any subsequent change in the value of the foreign currency is irrelevant for purposes of the tax imposed by Code sec. 2101.

(c) Invoice Charge for Excise Tax.—A disposing member may reflect on a bill to an acquiring member the tax imposed by Code sec. 2101 on a taxable acquisition. The tax shall be equal to the applicable percentage (set forth in Code sec. 2101(b)(4)) multiplied by the value of personal property or services determined under this article. Where the controlled group that includes the acquiring and disposing members reasonably projects that the tax imposed by Code sec. 2101 on the taxable acquisition will be reduced as a result of the application of one or more credits in Reg. § 2102(a)-2, the disposing member may reflect a reasonable estimate of the tax imposed by Code sec. 2101 on such taxable acquisition, taking into account the reduction of tax as a result of the application of such credit or credits.

Reg. 2101(c)-1 to 2101(c)-3

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) 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.

(3) For purposes of Chapter 7 of Subtitle B, a person may not be treated as a member of more than one controlled group. If any person would otherwise be regarded as a member of more than one group under this article, 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 for purposes of Chapter 7 of Subtitle B.

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 (without regard to whether such receipts or income are from sources within or without Puerto Rico).

(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 had $6,000,000 of gross interest income. The person had gross receipts of $86,000,000 for 2009.

Reg. 2101(d)-1 to 2101(d)-2

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) 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 tolling, 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 time of acquisition of property or services, 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 acquisitions of such property from the coverage of Code sec. 2101 shall constitute a transaction or 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 transaction subject to tax under Code sec. 2101, 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 (and now conducted by Company S), the formation of Company S will be treated as having as a principal purpose the avoidance of Code sec. 2101 and 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. Therefore, acquisitions from Company S by other members of the

controlled group in 2011 would be subject to tax under Code sec. 2101. 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. 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 the acquirer 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, a member of the Group A controlled group within the meaning of Reg. § 2101(c)-1, acquired Product X 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 X to be acquired by New Purchaser, a company that is not part of Group A but engages in transactions involving Product X 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 procedures 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.

Example 4. Company A and Company B are members of the same controlled group. Company A manufactures Product X in Puerto Rico and sells Product X to Company B, a corporation organized in Country U, in transactions that would, if they occurred on or after January 1, 2011 and before January 1, 2017, be subject to tax under Code sec. 2101. On November 1, 2010, Company B acquires the manufacturing business previously carried out by Company A in Puerto Rico. After November 1, 2010, Company B operates that manufacturing business as a branch in Puerto Rico. Company B sells Product X to unrelated parties before and after January 1, 2011. Because acquisitions by unrelated parties from Company B would not ordinarily be subject to the tax imposed by Code sec. 2101, unless the controlled group establishes to the satisfaction of the Secretary, by clear and convincing evidence, that the acquisition of Company A's manufacturing business by Company B did not have as a principal purpose the avoidance of the tax imposed under Code sec. 2101, the acquisition of the manufacturing business from Company A (however effected) will be disregarded, and with respect to transactions occurring after December 31, 2010, Product X will be treated as having been manufactured by Company A in Puerto Rico, and Company B will be treated as having acquired Product X from Company A in transactions subject to tax under Code sec. 2101.

Example 5. The facts are the same as in Example 4, except that Company C is also a member of the same controlled group as Company A and Company B, and Company B sells Product X to Company C and not to unrelated parties. After the acquisition of Company A's manufacturing business on November 1, 2010, Company B is treated as manufacturing Product X in Puerto Rico as a result of the activities of its branch. The acquisition of Product X by Company C from Company B after December 31, 2010 is subject to the tax imposed under Code sec. 2101.

Reg. 2102(a)-1 to 2102(a)-3

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 (15th) day of the month following the month in which the acquisition of the personal property or services occurs.

(b) Penalty.—Any person that does not collect the tax or does not timely deposit the tax collected, shall be subject to a penalty of two (2) percent of the insufficiency if the omission is for thirty (30) days or less, and an additional penalty of two (2) percent of the insufficiency for each thirty (30) day period or fraction thereof for which the omission continues, provided the penalty shall not exceed twenty-four (24) percent of the insufficiency. For purposes of this paragraph (b), the term "insufficiency" shall mean the excess of the amount of tax that should have been deposited over the amount of tax deposited on or before the date the tax is required to be deposited.

(c) 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 in 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).

Example 5. Company B acquires property subject to tax under Code sec. 2101 from Company A on January 15, 2011 for 200 units of foreign currency. On January 15, 2011, the 200 units of foreign currency have a value of $100. Company A must collect and deposit $4 (the excise tax with respect to the acquisition for $100) on before February 15, 2011. The value of any foreign currency is determined on the date of the acquisition. Any subsequent change in the value of the foreign currency is irrelevant for purposes of the tax imposed by Code sec. 2101.

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, subject to the limitations in paragraph (i)(3), reduce the liability for such tax, but not below zero, by applying the credits described in paragraphs (b) through (h) below. The amount of any credits applied for each calendar month shall be reflected in the quarterly excise tax return that is required to be filed in accordance with Reg. § 2103(a)-1 for the quarter that includes such month. A quarterly excise tax return must be filed for each calendar quarter in which a member of the controlled group makes a taxable

acquisition, even if no tax is owing as a result of the application of the credits in this article.

(1) The credits in paragraphs (b) through (h) of this article shall apply with respect to each controlled group as a whole.

(2) Except as otherwise provided in this article, the amount of the credit in each of paragraphs (b) through (h) shall be allocated among all acquiring members of the controlled group that make acquisitions subject to tax under Code sec. 2101 according to their respective acquisitions subject to tax under Code sec. 2101 computed on a cumulative basis during the calendar year as of the end of each calendar month. See paragraph (j), Examples 10-12 for the application of this rule.

(3) Alternatively, a controlled group may allocate among all acquiring members the amount of the credit in each of paragraphs (b) through (h) below for each month according to their respective taxable acquisitions in that month. The method in this subparagraph (a)(3) or the method described in subparagraph (a)(2) must be used consistently for an entire calendar year. See paragraph (j), Examples 13-15 for the application of this rule.

(4) 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 under Code sec. 2101 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 this subparagraph (b)(3) or subparagraph (b)(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 (12), adjusted to reflect the amount of any credit in this paragraph (b) that could have been claimed in a prior month in the same calendar year but was not claimed because the amount of such credit exceeded the tax on taxable acquisitions in the prior month or because a credit under paragraph (c) or (d) was erroneously claimed. See paragraph (j), Example 2. The credit under this paragraph (b) shall be reflected on the monthly excise tax deposit form for each calendar month as required by the Secretary.

(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 disposing member of the controlled group 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 employees (as defined in subparagraph (i)(2)) employed in manufacturing or

producing personal property, or manufacturing services, in Puerto Rico, and such projections shall be attached to each quarterly excise tax return, 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 a calendar year, 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 employees in Puerto Rico of such members for the calendar year or the average monthly number of employees in Puerto Rico for calendar quarter ending December 31, whichever is higher,

is less than five hundred fifty thousand (550,000) 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. Upon consultation with the Secretary of Economic Development and Commerce, the Secretary may make adjustments to the five hundred and fifty thousand (550,000) dollar threshold for a controlled group, taking into account local employment and such other

matters as may be appropriate. Any discretionary adjustment made under this provision may be limited and subject to terms and conditions.

(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 this subparagraph (c)(4) or subparagraph (c)(5), the credit under this paragraph (c) that may be used for any calendar month may not exceed the amount of the annual credit under subparagraph (c)(2) or (c)(3) divided by twelve (12), adjusted to reflect the amount of any credit in this paragraph (c) that could have been claimed in a prior month in the same calendar year but was not claimed because the amount of such credit exceeded the tax on taxable acquisitions in the prior month or because a credit under paragraph (d) was erroneously claimed. See paragraph (j), Example 7.

(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 of the controlled group 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 with 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 employees (as defined in subparagraph (i)(2)) 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 excise tax return, 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, for example, the gross receipts per employee exceed the threshold in subparagraph (c)(2), 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.

(8) An election to use the credit described in this paragraph (c) for a calendar year shall be made by claiming the credit described in this paragraph (c) on the first monthly excise tax deposit form filed for a calendar year or on a form for a subsequent calendar month in which the controlled group determines that it is eligible for such credit.

(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 or production and manufacturing services in Puerto Rico that equals or exceeds four hundred (400), and

(iii) total compensation for such employees that equals or exceeds twenty million (20,000,000) dollars (for this purpose, compensation includes all amounts paid for services rendered, including bonuses, vacation allowances, and fringe benefits)

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) dollars, 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) for the level of taxable acquisitions in such year.

(4) The credit in this paragraph (d) used for any calendar month may not exceed the amount of the annual credit in subparagraph (d)(2) divided by twelve (12), adjusted to reflect the amount of any credit in this paragraph (d) that could have been claimed in a prior month in the same calendar year but was not claimed and to reflect any credit under paragraph (b) or (c) in this article that was claimed. See paragraph (j), Example 7.

(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 employees (as defined in subparagraph (i)(2)) employed, and the compensation of such employees related thereto, in manufacturing or producing personal property, or performing manufacturing services, in Puerto Rico, and the amount of taxable acquisitions, and such projections shall be attached to each quarterly excise tax return, 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.

(7) An election to use the credit described in this paragraph (d) for a calendar year shall be made by claiming the credit described in this paragraph (d) on the first monthly excise tax deposit form filed for a calendar year or on a form for a subsequent calendar month in which the controlled group determines that it is eligible for such credit.

(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 also 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 twenty-five (25) employees, the controlled group shall be entitled to a credit of one hundred eighty-seven thousand five hundred (187,500) dollars, plus an additional one hundred eighty-seven thousand five hundred (187,500) dollars for each additional twenty-five (25) employees to a maximum of five hundred (500) additional employees, for a maximum credit of 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 employees (as defined in subparagraph (i)(2)) to be employed in each month of that calendar year in manufacturing or producing personal property, or manufacturing services, in Puerto Rico and the amount of taxable acquisitions, and such projections shall be attached to each quarterly excise tax return, 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.

(6) An election to use the credit described in this paragraph (e) for a calendar year shall be made by claiming the credit described in this paragraph (e) on the first monthly excise tax deposit form filed for a calendar year or on a form for a subsequent calendar month in which the controlled group determines that it is eligible for such credit.

(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 subparagraph (f)(2) below may elect the credit provided by this paragraph (f).

(2) In the case of a controlled group that has one or more members that are engaged in manufacturing and production or manufacturing services in facilities located in three (3) or more different municipalities in Puerto Rico as of October 24, 2010, a credit of five million (5,000,000) dollars per each such municipality shall be allowed for each such facility that has a monthly average of more than thirty (30) employees during the calendar year for which a credit is claimed under this paragraph (f), up to a maximum credit of twenty million (20,000,000) dollars with respect to all such municipalities.

(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 (12).

(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 excise tax return. 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.

(7) An election to use the credit described in this paragraph (f) for a calendar year shall be made by claiming the credit described in this paragraph (f) on the first monthly excise tax deposit form filed for a calendar year or on a form for a subsequent calendar month in which the controlled group determines that it is eligible for such credit.

(g) Economically Disadvantaged or Critical Industry Suppliers.—

(1) If a controlled group makes direct purchases of property or services from a supplier certified by the Secretary and by the Department of Economic Development and Commerce as an economically disadvantaged or critical industry business ("Economically Disadvantaged or Critical Industry Supplier"), then a credit shall be allowed as described in this paragraph (g).

(2) Amount of Credit.—

(i) If, during a calendar year, the costs of direct purchases of property and services from Economically Disadvantaged or Critical Industry Suppliers made by members of a controlled group are less than or equal to seventy-five (75)

percent of its total purchases of property and services, and purchases from Economically Disadvantaged or Critical Industry Suppliers are in excess of the average annual direct purchases of property and services from Economically Disadvantaged or Critical Industry 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) If, during a calendar year, the costs of direct purchases of property and services from Economically Disadvantaged or Critical Industry Suppliers made by members of a controlled group are in excess of seventy-five (75) percent of its total purchases of property and services for such calendar year, 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) without regard to the credits provided in this paragraph (g).

(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 costs of its purchases of property and services from Economically Disadvantaged or Critical Industry 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. (All certificates of Economically Disadvantaged or Critical Industry Suppliers shall be made available for review upon request.) 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 this 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.

(6) An election to use the credit described in this paragraph (g) for a calendar year shall be made by claiming the credit described in this paragraph (g) on the first monthly excise tax deposit form filed for a calendar year or on a form for a subsequent calendar month in which the controlled group determines that it is eligible for such credit.

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

(1) If, during a calendar year, 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) If 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 one hundred (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) If 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 one hundred (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) Investment in Research and Development Activities.—The term "investment in research and development activities," as used in this article, means expenditures incurred in Puerto Rico in connection with the controlled group's trade or business which represent research and development costs in the experimental or laboratory sense. The term generally includes all such costs incident to the development or improvement of a product. Expenditures represent research and development costs in the experimental or laboratory sense if they are for activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. Uncertainty exists if the information available to the taxpayer does not establish the capability or method for developing or improving the product or the appropriate design of the product. Whether expenditures qualify as research or experimental expenditures depends on the nature of the activity to which the expenditures relate, not the nature of the product or improvement being developed or the level of technological advancement the product or improvement represents.

(i) For purposes of this article, the term "product" includes any pilot, model, process, formula, invention, technique, or similar property, and includes products to be used by the taxpayer in its trade or business as well as products to be held for sale, lease, or license.

(ii) The term research and development expenditures does not include expenditures for:

(I) The ordinary testing or inspection of materials or products for quality control (quality control testing);

(II) Efficiency surveys;

(III) Management studies;

(IV) Consumer surveys;

(V) Advertising or promotions;

(VI) The acquisition of a patent, model, production or process;

(VII) Research in connection with literary, historical, or similar projects; or

(VIII) Items that must be capitalized for income tax purposes (but expenditures may include depreciation or amortization with respect to such items).

(5) A controlled group shall adequately document the qualifying 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.

(6) An election to use the credit described in this paragraph (h) for a calendar year shall be made by claiming the credit described in this paragraph (h) on the first monthly excise tax deposit form filed for a calendar year or on a form for a subsequent calendar month in which the controlled group determines that it is eligible for such credit.

(i) Definitions and Special Rules.—

(1) Employee Baseline Defined.—

(i) The employee baseline for a controlled group shall be the average monthly number of employees (as defined in subparagraph (i)(2)) engaged in manufacturing or production or manufacturing services in Puerto Rico for the twelve (12) months ended September 30, 2010. Alternatively, a controlled group may elect to use as the employee baseline the number of employees engaged in manufacturing and production or manufacturing services in Puerto Rico on September 30, 2010.

(ii) Discretionary Adjustments to Employee Baseline.— Upon consultation with the Secretary of Economic Development and Commerce, the Secretary may make adjustments to the employee baseline of any controlled group otherwise determined under this subparagraph (i)(1), taking into account local employment and such other matters as may be appropriate.

(I) The appropriate circumstances for such adjustments to a controlled group's employee baseline include circumstances where a controlled group demonstrates, by clear and convincing evidence, that its worldwide employment has decreased, where a controlled group makes acquisitions or dispositions of trades or businesses, and where a controlled group has experienced other exceptional circumstances. Exceptional 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.

(II) Any discretionary adjustment made under this provision may be limited and subject to terms and conditions. Unless the Secretary specifically determines otherwise, such a discretionary adjustment shall not reduce the employee baseline for purposes of the computation of the amount of the credit, if any, available under paragraph (e).

(2) Employee Defined.—For purposes of this article, "employee" means an individual who performs activities in Puerto Rico on behalf of one or more members of a controlled group and is treated as a full-time employee under this subparagraph (i).

(i) Full-time employee.—The term "full-time employee" means, with respect to any month, an employee who is employed by one or more members of a controlled group on average at least forty (40) hours of service per week in Puerto Rico and whose compensation is reported on Form 941-PR by one or more members of the controlled group.

(ii) Full-time equivalents treated as full-time employees.— For purposes of this article, in addition to the number of full-time employees for any month otherwise determined, a controlled group shall include for such month a number of full-time employees determined by dividing the aggregate number of hours of service of employees who are not full-time employees for the month by one hundred sixty (160). For this purpose, employees who are not full-time employees include temporary, part-time, and other individuals whose compensation is reported on Form 941-PR by one or more members of the controlled group and does not include contractors and other service providers.

(3) Limitations 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 manufacturing and production and manufacturing services in Puerto Rico for the twelve (12) months of such calendar year that is less than ninety (90) percent of the controlled group's employee baseline. Nor shall any credit be permitted under this Reg. § 2102(a)-2 to any member of a controlled group for a calendar quarter in which the controlled group has failed to deposit or pay with the return due for such calendar quarter at least seventy-five (75) percent of the tax due for such calendar quarter under Code sec. 2101.

(j) Examples.—Except as otherwise stated, all examples in this paragraph (j) assume that the requirements of paragraph (i) are satisfied.

Example 1. In December 2010**,** the controlled group of which Company B is a member projects taxable acquisitions for 2011 of $125,000,000. In January 2011, there are taxable acquisitions of $8,000,000 and the controlled group claims a credit under paragraph (b) of $320,000 (4 percent [the tax rate for 2011] times 8,000,000, which is less than the maximum monthly credit for January under paragraph (b) of 333,000). In February 2011, there are taxable acquisitions of $12,000,000. The controlled group may claim a credit for February 2011 of $346,666 ($4,000,000 [the maximum under this paragraph (b)] divided by 12 [$333,333] times 2 [$666,666] less $320,000 [the credit claimed for January 2011]).

Example 2. During 2011, the controlled group of which Company C is a member has an average monthly number of employees engaged in manufacturing and production and manufacturing services in Puerto Rico that equals or exceeds the amount specified in subdivision (d)(1)(ii). In December 2010, the controlled group reasonably projects taxable acquisitions for 2011 of $4,200,000,000. In January 2011, the controlled group, in the aggregate, has taxable acquisitions of $350,000,000, resulting in a pre-credit tax of $14,000,000. The controlled group claims a credit under paragraph (d) of $1,666,667 ($20,000,000 divided by 12). Because the controlled group claims a credit under paragraph (d), the controlled group may not claim a credit under paragraph (b) or paragraph (c).

In February 2011, the controlled group revises its projections of taxable acquisitions for 2011 from $4,200,000,000 to $3,600,000,000. Based on the revised projections, the controlled group may not claim a credit for 2011 under paragraph (d), but may claim a credit for 2011 under paragraph (b). Because the controlled group erroneously claimed a credit of $1,666,667 under paragraph (d) for January 2011, the controlled group may not claim a credit under paragraph (b) until June 2011 (provided its revised projections are correct). Under paragraph (b), a controlled group may claim a maximum of $333,333 of credit per month in 2011, adjusted to reflect the amount of

any credit under paragraph (b) that could have been claimed in a prior month in the same calendar year but was not claimed. Because the controlled group claimed $1,666,667 under paragraph (d) in January 2011, the controlled group may not claim a credit under paragraph (b) for February, March, April, or May ($1,666,667 minus $333,333 for each month until the erroneously claimed credit is exhausted), and the amount of the credit for June would be $333,333.

Example 3. In December 2010, the controlled group of which Company D is a member reasonably projects that its taxable acquisitions for 2011 will be $180,000,000 and that its gross receipts per employee for 2011 will be $485,000. Prior to the application of any credits, the controlled group of which Company D is a member projects that it will be liable for tax under Code sec. 2101 of $600,000 per month (4 percent times $180,000,000 [$7,200,000] divided by 12 [$600,000]). Based on these projections, the controlled group claims a credit under paragraph (c) of $583,333 per month ($7,000,000 divided by 12) and therefore pays a tax of $16,666 per month. The controlled group's taxable acquisitions for 2011 in fact are $174,000,000. The controlled group's excise tax liability is reduced to zero by the credit provided in paragraph (c). As a consequence, no acquiring member of the controlled group is subject to the tax imposed by Code sec. 2101 in 2011, and therefore each acquiring member would be subject to the rules of Code sec. 1123(f)(4). Each acquiring member shall be entitled to a refund of any tax paid under Code sec. 2101 for the calendar year in accordance with subparagraph (c)(6).

Example 4. The facts are the same as in Example 3, except that the gross receipts per employee for the controlled group for 2011 are $512,000. As a consequence, no credit is allowable under paragraph (c). A credit would be permitted under paragraph (b). The credit under paragraph (b) is $333,333 per month ($4,000,000 divided by 12), and, based on taxable acquisitions of $174,000,000 in 2011, the tax liability under Code. sec. 2101 for the acquiring members of the controlled group in 2011 is $2,960,000 ($6,960,000 minus $4,000,000).

Example 5. The facts are the same as in Example 4, except that the controlled group has an average monthly number of full-time employees engaged in manufacturing or production and manufacturing services in Puerto Rico for the twelve (12) months in 2011 that is less than ninety (90) percent of the controlled group's employee baseline. No credit is available under this article because the requirements of paragraph (i) are not satisfied, and the tax liability of the controlled group for 2011 is $6,960,000.

*Example 6***.** In 2011**,** the controlled group of which Company E is a member has an average monthly number of employees engaged in manufacturing or production and manufacturing services in Puerto Rico that equals or exceeds the number specified in subdivision (d)(1)(ii) and has taxable acquisitions of $4,250,000,000. Such controlled group is entitled to a credit of $20,000,000 in 2011. The controlled group may claim up to one-twelfth of this amount ($1,666,667) in each month of 2011.

Example 7. In 2011**,** the controlled group of which Company E is a member has an average monthly number of employees engaged in manufacturing or production and manufacturing services in Puerto Rico that equals or exceeds the number specified in subdivision (d)(1)(ii). In December 2010, the controlled group of which Company E is a member reasonably projects that the taxable acquisitions by all members of the controlled group for 2011 will be $3,900,000,000. In March 2011, the controlled group revises its projections of taxable acquisitions from $3,900,000,000 to $4,250,000,000. Based on the original projections, the controlled group does not claim a credit under paragraph (d) for January or February 2011. For March 2011, the controlled group may claim a credit in the amount of the excess of $5,000,000 (the credit computed under paragraph (d) of $1,666,667 for each of January, February, and March 2011) less the amount of any credit claimed under paragraph (b) or (c) for January and February 2011.

Example 8. In 2011**,** the controlled group of which Company E is a member has an average monthly number of employees engaged in manufacturing or production and manufacturing services in Puerto Rico that equals or exceeds the number specified in subdivision (d)(1)(ii) and reasonably projects that the taxable acquisitions by all

members of the controlled group for 2011 will be $4,600,000,000. Based on this projection, the controlled group claims a credit under paragraph (d)(2)(ii) of $3,333,333 each month from January through November 2011 ($40,000,000 divided by 12). In fact, the controlled group's taxable acquisitions amount to $4,400,000,000 for 2011. The controlled group is entitled to a credit under subdivision (d)(2)(i) of $20,000,000 for the year rather than a credit of $40,000,000 for the year under subdivision (d)(2)(ii). As a result, the controlled group is treated as having an additional tax of $18,333,333 arising on account of an acquisition deemed to occur during the month of December of such year (the difference between the 11-month portion of the $40,000,000 credit under subdivision (d)(2)(ii) [$36,666,667] and the 11-month portion of the $20,000,000 credit under subdivision (d)(2)(i) [$18,333,333]). The controlled group may claim a credit of $1,666,667 for December 2011.

Example 9. The facts are the same as in Example 8, except that in December 2011 the controlled group determines that it had an average monthly number of employees engaged in manufacturing and production and manufacturing services in Puerto Rico for the twelve (12) months in 2011 that is less than ninety (90) percent of the controlled group's employee baseline. No credit is available under this article because the requirements of subparagraph (i)(3) are not satisfied. As a result, the controlled group is treated as having an additional tax of $36,666,667 arising on account of an acquisition deemed to occur during the month of December of such year.

Example 10. A controlled group of corporations consists of Company F, Company G, and Company H. Company F makes taxable acquisitions of $10,000,000 each month from Company H in 2011. Company G makes taxable acquisitions of $5,000,000 from Company H each month in 2011. The controlled group is entitled to a monthly credit of $333,333 ($4,000,000 divided by 12) under paragraph (b) for 2011. In the aggregate, Company F and Company G are liable for tax of $266,667 for each month ($15,000,000 of taxable acquisitions, resulting in a pre-credit tax of $600,000 each month, less the monthly credit of $333,333). The credit under paragraph (b) is allocated each month $222,222 to Company F and $111,111 to Company G,

proportionate to their respective taxable acquisitions computed according to the method described in subparagraph (a)(2) on a cumulative basis during the calendar year as of the end of each calendar month. As result, under this method, Company F is liable for $177,778 of tax for each month, and Company G is liable for tax of $88,889 of tax for each month.

Example 11. The facts are the same as in Example 10, except that Company G has no taxable acquisitions in January 2011 and taxable acquisitions of $5,000,000 in February 2011. For January 2011, Company F is liable for $66,667 of tax ($10,000,000 of taxable acquisitions, resulting in $400,000 of pre-credit tax less a credit of $333,333). For February 2011, in the aggregate, Company F and Company G are liable for tax of $266,667 ($15,000,000 of taxable acquisitions resulting in a pre-credit tax of $600,000, less the monthly credit of $333,333). As of the end of February 2011, the cumulative credits ($666,666) are allocated on the basis of the ratio of $20,000,000 of taxable acquisitions by Company F ($10,000,000 for January and $10,000,000 for February) and $5,000,000 of taxable acquisitions by Company G. Thus, at the end of February 2011, Company F is allocated a total of $533,333 of the credits (4/5 of $666,666) and Company G is allocated a total of $133,333 (1/5 of $666,666). Therefore, for February 2011, Company F is allocated $200,000 of credits and Company G is allocated $133,333 of credits. As a result, Company F is liable for tax of $200,000 ($10,000,000 of taxable acquisitions resulting in $400,000 of pre-credit tax less $200,000 of credits) and Company G is liable for tax of $66,667 ($5,000,000 in taxable acquisitions resulting in $200,000 of pre-credit tax less $133,333 of credits).

Example 12. The facts are the same as in Example 11, except that Company G has taxable acquisitions of $10,000,000 in February 2011. For January 2011, Company F is liable for $66,667 of tax ($10,000,000 of taxable acquisitions, resulting in $400,000 of pre-credit tax less a credit of $333,333). For February 2011, in the aggregate, Company F and Company G are liable for tax of $466,667 ($20,000,000 of taxable acquisitions resulting in a pre-credit tax of $800,000, less the monthly credit of $333,333). As of the end of February 2011, the cumulative credits ($666,666) are

allocated on the basis of the ratio of $20,000,000 of taxable acquisitions by Company F ($10,000,000 for January and $10,000,000 for February) and $10,000,000 of taxable acquisitions by Company G. Thus, at the end of February 2011, Company F is allocated a total of $444,444 of the credits (2/3 of $666,666) and Company G is allocated a total of $222,222 (1/3 of $666,666). Therefore, for February 2011, Company F is allocated $111,111 of credits and Company G is allocated $222,222 of credits. As a result, Company F is liable for tax of $288,889 for February 2011 ($10,000,000 of taxable acquisitions resulting in $400,000 of pre-credit tax less $111,111 of credits) and Company G is liable for tax of $177,778 for February 2011 ($10,000,000 in taxable acquisitions resulting in $400,000 of pre-credit tax less $222,222 of credits).

Example 13. The facts are the same as in example 10, except that the controlled group elects to allocate the credit under paragraph (b) in accordance with the method described in subparagraph (a)(3) instead of subparagraph (a)(2). Company F makes taxable acquisitions of $10,000,000 each month from Company H in 2011. Company G makes taxable acquisitions of $5,000,000 from Company H each month in 2011. The controlled group is entitled to a monthly credit of $333,333 ($4,000,000 divided by 12) under paragraph (b) for 2011. In the aggregate, Company F and Company G are liable for tax of $266,667 for each month ($15,000,000 of taxable acquisitions resulting in a pre-credit tax of $600,000 each month less the monthly credit of $333,333). The credit under paragraph (b) is allocated each month $222,222 to Company F and $111,111 to Company G, proportionately to their respective taxable acquisitions computed according to the method described in subparagraph (a)(3) based on the taxable acquisitions by each acquiring member during each month and not on a cumulative basis. As result, under this method, Company F is liable for $177,778 of tax for each month, and Company G is liable for tax of $88,889 of tax for each month.

Example 14. The facts are the same as in Example 13, except that Company G has no taxable acquisitions in January 2011 and taxable acquisitions of $5,000,000 in February 2011. For January 2011, Company F is liable for $66,667 of tax ($10,000,000 of taxable acquisitions, resulting in $400,000 of pre-credit tax, less a credit of $333,333).

For February 2011, in the aggregate, Company F and Company G are liable for tax of $266,667 ($15,000,000 of taxable acquisitions resulting in a pre-credit tax of $600,000 less the monthly credit of $333,333). For February 2011, the credits ($333,333) are allocated on the basis of the ratio of $10,000,000 of taxable acquisitions by Company F and $5,000,000 of taxable acquisitions by Company G. Thus, for February 2011, Company F is allocated a total of $222,222 of the credits (2/3 of $333,333) and Company G is allocated a total of $111,111 (1/3 of $333,333). As a result, Company F is liable for tax of $177,778 ($10,000,000 of taxable acquisitions resulting in $400,000 of pre-credit tax less $222,222 of credits) and Company G is liable for tax of $88,889 ($5,000,000 in taxable acquisitions resulting in $200,000 of pre-credit tax, less $111,111 of credits).

Example 15. The facts are the same as in Example 14, except that Company G has taxable acquisitions of $10,000,000 in February 2011. For January 2011, Company F is liable for $66,667 of tax ($10,000,000 of taxable acquisitions, resulting in $400,000 of pre-credit tax less a credit of $333,333). For February 2011, in the aggregate, Company F and Company G are liable for tax of $466,667 ($20,000,000 of taxable acquisitions resulting in a pre-credit tax of $800,000 less the monthly credit of $333,333). For February 2011, the credit ($333,333) is allocated on the basis of the ratio of $10,000,000 of taxable acquisitions by Company F and $10,000,000 of taxable acquisitions by Company G. Thus, for February 2011, Company F is allocated a $166,667 of the credits (1/2 of $333,333) and Company G is allocated $166,667 (1/2 of $333,333). As a result, Company F is liable for tax of $233,333 ($10,000,000 of taxable acquisitions resulting in $400,000 of pre-credit tax less $166,667 of credits), and Company G is liable for tax of $233,333 ($10,000,000 in taxable acquisitions resulting in $400,000 of pre-credit tax less $166,667 of credits).

Example 16. Company H and Company I are members of the same controlled group. For the 12 months ended September 30, 2010, the average monthly employment of the controlled group is 250 employees. On September 30, 2010, the controlled group has 240 employees. The controlled group elects to use 240

employees as the employee baseline. In 2011, the controlled group requests that the Secretary adjust its employee baseline and is able to demonstrate by clear and convincing evidence that its worldwide employment has declined by 10 percent. The Secretary may, after consultation with the Secretary of Economic Development and Commerce, determine that the employee baseline for the controlled group is 216 (240 less 10 percent or 24). However, if the Secretary agrees to make such adjustment, unless the Secretary specifically determines otherwise, the adjustment will not reduce the employee baseline for purposes of computation of the amount of the credit, if any, available under paragraph (e). Therefore, for purposes of paragraph (e), the employee baseline will be 240.

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 Economically Disadvantaged or Critical Industry 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 Economically Disadvantaged or Critical Industry 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 (12) months of 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). Nor shall the maximum tax limitation in paragraphs (a) and (b) apply to a controlled group for a calendar year in which the controlled group has failed to deposit or pay with the return due for any calendar quarter in such calendar year at least seventy-five (75) percent of the tax due for such calendar quarter under Code sec. 2101.

Reg. 2103(a)-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 shall be required to file a tax return for each calendar quarter no later than the last day of the month following the end of the calendar quarter 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 specified in these regulations and in the instructions to the form.

(b) Unless otherwise provided 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 reductions in tax under Reg. § 2104(a)-1, 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. A quarterly return must be filed for each calendar quarter in which a member of the controlled group makes a taxable acquisition, even if no tax is owing as a result of the application of the credits in Reg. § 2102(a)-2.

<u>Reg. 2104(a)-1</u>

Reg. § 2104(a)-1. Reductions for Certain Taxes Paid. (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), but shall not include any U.S. federal excise tax or any income tax imposed by any jurisdiction.

(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 otherwise provided in 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. In the case of a second tax other than a tax under Code sec. 2101, if an exemption or credit is available for such second tax, the reduction permitted under this paragraph (b) shall be reduced by the amount of the exemption or credit allowed or allowable.

(c) Ordering Rule.—Any reductions in tax under this article shall be reflected in the computation of the aggregate tax liability of a controlled group prior to the computation and application of any credits described in Reg. § 2102(a)-2.

(d) 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 property 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 property 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 employees 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 from the State Q sales tax, Company C would not be entitled to reduce its excise tax by $2.

Example 4. Company A, Company T1, and Company T2 are members of the same controlled group. Company T1 obtains physical possession of tangible property

from Company A that was not manufactured or produced in Puerto Rico, and Company T1 substantially transforms such tangible property through the activities of its employees or contractors in Puerto Rico on behalf of Company A pursuant to a contract. Company A maintains legal title and beneficial ownership of the property throughout the substantial transformation. Following the substantial transformation by Company T1, Company T1 places the tangible property in the custody of a common carrier in Puerto Rico at Company A's instruction for delivery to Company T2. Company T2 receives the tangible property placed in the custody of a common carrier by Company T1. Company T2 acquires the property from Company A (after Company A has, through its contractual arrangement with Company T1, manufactured or produced the tangible property in Puerto Rico) in a transaction subject to tax under Code sec. 2101. Company T2 further substantially transforms the tangible property through the activities of its employees or contractors in Puerto Rico on behalf of Company A. Following the substantial transformation, Company T2 places the tangible property in the custody of a common carrier in Puerto Rico for delivery to Company A or a party designated by Company A.

Company A is treated as acquiring the tangible property from Company T1 at the time that the tangible property is placed in the custody of the common carrier for delivery to Company T2 at Company A's instruction. Company A is liable for tax under Code sec. 2101 as a result of the acquisition from Company T1. However, in addition, Company T2 is treated as acquiring the tangible property from Company A, and therefore Company T2 is liable for tax under Code sec. 2101, and Company A may reduce its tax on the acquisition from Company T1. Furthermore, following the substantial transformation by Company T2, Company A is treated as acquiring the tangible property from Company T2 in a transaction subject to tax under Code sec. 2101 at the time that the tangible property is placed in the custody of the common carrier by Company T2 for delivery to Company A or a party designated by Company A. At that time, Company T2 may reduce its tax on the acquisition from Company A. Therefore, if Company A subsequently sells the tangible property to an unrelated party, Company A is ultimately liable for the tax imposed by Code sec. 2101 as a result of the

series of transactions described in this example and such ultimate tax is imposed on the acquisition by Company A from Company T2. If, however, Company A subsequently sells the tangible property to another member of the controlled group, then such a transaction would be subject to tax under Code sec. 2101 (because Company A is treated as having manufactured or produced the tangible property in Puerto Rico as a result of its contractual arrangement with Company T2), and Company A would be entitled to reduce its tax on the acquisition from Company T2."

SEVERABILITY: If any article, section, paragraph, subparagraph, clause, phrase or part of the Code or this Regulation shall be declared invalid, illegal, unenforceable or unconstitutional to any extent by a court of competent jurisdiction, the judgment to that effect shall not affect, annul or void the remainder of the Code or this Regulation, being the effects of such judgment limited to the article, section, paragraph, subparagraph, clause, phrase or part of the Code or this Regulation declared invalid, illegal, unenforceable or unconstitutional.

EFFECTIVENESS: In accordance with the provisions of Section 2.13 of Act No. 170 of August 12, 1988, as amended, known as the "Commonwealth of Puerto Rico Uniform Administrative Procedures Act", this Regulation shall become effective immediately after it is filed at the Department of State.

Approved in San Juan, Puerto Rico, on December 29, 2010.

Juan Carlos Puig
Secretary of the Treasury

Filed at the Department of State on December ____, 2010.

GOVERNMENT OF PUERTO RICO
DEPARTMENT OF THE TREASURY

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