



Jesús F. Méndez Rodríguez, CPA
Secretary of the Treasury

November 16, 2011

ADMINISTRATIVE DETERMINATION NO. 11-13

**ATTENTION: ALL TAXPAYERS SUBJECT TO THE REQUIREMENT OF FILING
AUDITED FINANCIAL STATEMENTS WITH THEIR INCOME TAX
RETURNS**

**SUBJECT: PROVISIONS UNDER THE INTERNAL REVENUE CODE FOR A NEW
PUERTO RICO**

I. STATEMENT OF MOTIVES

The Department of the Treasury ("Department") has received consultations about the provisions of Section 1061.15 of the Internal Revenue Code for a New Puerto Rico ("Code"), related to the requirement of filing audited financial statements with the income tax return.

As part of the tax reform, several provisions were amended regarding the requirement of filing audited financial statements with the income tax return. Among them is Section 1061.15(a)(3) of the Code, which establishes the requirement of submitting consolidated financial statements to groups of related entities doing business in Puerto Rico.

In the case of groups of related entities, the Department has received consultations about how to determine the group's business volume when the related entities that are part of the group do not have the same annual accounting period. The Department has also received requests from taxpayers expressing their need for additional time for complying with the new requirements imposed by Section 1061.15(a)(3) of the Code regarding consolidated financial statements. Additionally, the Legislative Assembly is evaluating certain technical amendments regarding said section.

The purpose of this Administrative Determination is to clarify concerns that have originated regarding the provisions of Section 1061.15(a)(3) of the Code and to postpone the effectiveness of certain requirements included in this section, in anticipation of the technical amendments project that is being evaluated by the Legislative Assembly.

II. STATUTORY BASIS

Section 1061.15(a)(3) of the Code provides that every business, including an individual business, corporation, partnership, special partnership, limited liability company, corporation of individuals, insurance company, registered investments company, employee-owned special corporation, association, cooperative, real estate investment trust, or any other entity engaged in trade or business or engaged in the production of income in Puerto Rico, shall submit financial statements with their income tax returns when their business volume exceeds \$3,000,000.

A. Rule for determining business volume in the case of a group of related entities:

In the case of groups of related entities, as defined in Section 1010.05(a) of the Code, the term "business volume" shall be determined by adding the business volume of each of the entities included in said group. Therefore, if upon adding the business volume of each of the entities included in a group of related entities, the total exceeds \$3,000,000, each of the entities must submit audited financial statements with their income tax returns.

B. Requirement of submitting consolidated financial statements

In the case of groups of related entities, if more than one entity is engaged in trade or business in Puerto Rico, Section 1061.15(a)(3) of the Code provides that the audited financial statements shall be submitted in the form of consolidated financial statements, presenting the financial situation and the operation outputs of the parent entity and its subsidiaries as if they were one entity. It is also established that said consolidated statements shall include a consolidation attachment that shows, in columns, the financial situation and the outputs of operations of the parent company and each one of the subsidiaries or variable interest entities, including columns with entries for elimination and consolidated totals.

However, in the case of foreign entities engaged in trade or business in Puerto Rico, and which have the obligation of filing audited financial statements with their income tax returns (that is, foreign entities whose business volume attributable to the operation of an industry or business in Puerto Rico exceeds \$3,000,000 for taxable year 2011), consolidated financial statements that present the outputs of operations carried out in Puerto Rico as supplemental information will not be accepted if the Auditor's Report merely mentions that the entity has been audited at the consolidated level. In these cases, the foreign entity will be allowed to submit audited financial statements that only reflect the output of the operations carried out in Puerto Rico, without the requirement of submitting consolidated statements.



III. DISCUSSION AND DETERMINATIONS

A. Determination of business volume in the case of a group of related entities for taxable years that began during calendar year 2011:

In accordance with the foregoing, to determine if an entity that is part of a group of related entities engaged in trade or business in Puerto Rico is subject to submitting audited financial statements with its income tax return for the taxable year beginning during calendar year 2011, the business volume of each one of the entities included in said group will be added. Therefore, if upon adding the business volume of each one of the entities included in a group of related entities, the total exceeds \$3,000,000, each of the entities, individually, shall submit audited financial statements with the corresponding income tax return.

This way, if all the entities that make up a group of related entities have their annual accounting closing period on December 31, the business volume generated during the year ending on December 31, 2011 for each one of the entities of said group will be added. If the combined business volume of said entities exceeds \$3,000,000, each one of the entities shall submit audited financial statements with their income tax returns for taxable year 2011.

Rule applicable to groups of related entities with different annual accounting periods:

However, when entities that make up a group of related entities have different annual accounting period closings, the determination of whether all the entities that make up said group will be subject to submitting audited financial statements will be made only once, before the due date of the income tax return (without considering extensions) of the entity whose taxable year was the first to begin during calendar year 2011.

- At least one of the entities closes its annual accounting period on December 31, 2011:

When the annual accounting period of each one of the entities that make up the group of related entities is not the same, and at least one of the entities determines its income based on calendar year, the business volume of the entity (or entities) whose annual accounting period closing is on December 31, 2011 will be added to the business volume of each one of the related entities whose economic year ends in calendar year 2011.

For example, if a group of related entities is made up of 3 entities: Corporation A, with a year closing on December 31; Corporation B, with a year closing on September 30; and Corporation C, with a year closing on June 30; in order to determine if the business volume of said group of entities exceeds \$3,000,000 for taxable year 2011, the business volume will be considered in the following manner:



Entity	Closing of calendar year or economic year ended in the year 2011	Business volume	Taxable year beginning during calendar year 2011	Due date of return without extension for which audited financial statements shall be submitted
Corporation A	12-31-2011	\$2,000,000	01-01-2011	04-14-2012
Corporation B	09-30-2011	1,000,000	10-01-2011	01-15-2013
Corporation C	06-30-2011	1,500,000	07-01-2011	10-15-2012
Total business volume:		\$4,500,000		

In this case, since the sum of each one of the corporations that make up the group of related entities exceeds \$3,000,000, each one of said corporations shall submit audited financial statements with the filing of their income tax returns for the taxable year beginning during calendar year 2011.

- No entity shall determine its income based on a calendar year:

When the annual accounting period of each one of the entities that make up the group of related entities is not the same, and none of the entities determine their income based on a calendar year, the following will be added:

1. The business volume of that entity (or entities if several entities have the same yearly closing) whose annual accounting period is the first one to close after December 31, 2011, and
2. The business volume of those other related entities whose economic years end within the period of twelve (12) months ending with the closing of the annual accounting period of the entity (or entities) described in paragraph 1.

If in the previous example, the yearly closing of Corporation A were January 31, to determine if the business volume of said group of entities exceeds \$3,000,000 for taxable years beginning during calendar year 2011, the business volume shall be considered in the following manner:



Entity	Closing of calendar year or economic year considered for requirement ¹	Business volume	Taxable year beginning during calendar year 2011	Due date of return without extension for which audited financial statements shall be submitted
Corporation A	01-31-2012	\$2,000,000	02-01-2011	05-15-2012
Corporation B	09-30-2011	1,000,000	10-01-2011	01-15-2013
Corporation C	06-30-2011	1,500,000	07-01-2011	10-15-2012
Total business volume:		\$4,500,000		

Provided that the sum of the business volume of each one of the corporations that make up the group of related entities exceeds \$3,000,000, each one of said corporations shall submit audited financial statements with the filing of their income tax returns for their taxable years beginning during calendar year 2011.

In summary, when the annual accounting period of each one of the entities that make up a group of related entities is not the same, and at least one of them determines its income based on a calendar year, the business volume of the economic year ending during calendar year 2011 of each one of the entities of said group will be considered. If none of the entities determine their income based on a calendar year, the business volume for the economic years that end within the period of twelve (12) months that ends with the closing of the entity (or entities) whose annual accounting period is the first to close after December 31, 2011 will be considered.

B. Requirement of submitting consolidated financial statements

This Department also determines that, for the purpose of compliance with the requirement of filing audited financial statements with the income tax return for years beginning after December 31, 2010 and before January 1, 2012, every entity that has generated a business volume in excess of \$1,000,000 during said taxable year and which is part of a group of related entities subject to the provisions of Section 1061.15(a)(3) of the Code, because the business volume of said group of related entities exceeds \$3,000,000, may submit audited financial statements showing the financial situation and the outputs of operation of said entity individually, without the need to submit consolidated or combined financial statements; provided that they

¹ Corporation A is the entity whose annual accounting period is the first one to end after December 31, 2011. Therefore, for the purposes of determining the business volume of the group, the business volume of Corporation A for the taxable year ending on January 31, 2012 is added to the business volume of the other entities in the group for the economic years ending within the 12 months ending with the closing of the year of Corporation A, which is January 31, 2012.



include, in the notes to said financial statements, a list of all the related entities engaged in trade or business in Puerto Rico. Said information shall include the name of each one of the entities that are part of the group of related entities engaged in trade or business in Puerto Rico. An entity which is part of a group of related entities subject to the provisions of Section 1061.15(a)(3) of the Code but that has not accrued a business volume in excess of \$1,000,000 for its first taxable year beginning after December 31, 2010 will not have the obligation of filing audited financial statements for said year.

The previous determination shall be applicable to domestic entities and foreign entities engaged in trade or business in Puerto Rico that are part of a group of related entities.

This Determination is made in consideration of the duty of this Department to appropriately manage the provisions of the Code.

IV. EFFECTIVENESS

The provisions of this Administrative Determination are effective immediately. For additional information regarding the provisions of this Administrative Determination, you may contact the General Consultation Section at (787) 722-0216.

At the Department of the Treasury, we are here to serve you.

Cordially,



Jesús F. Méndez Rodríguez



Secretary of the Treasury