

Release date: December 30, 2016

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Code Sections: 1035.01; 1035.03; 1033.07(a); 1051.01

Topic: Source of income

Act: 1-2011

Date issued: December 30, 2016

Text

By letter of September 20, 2016, you requested on behalf of Taxpayers (as defined below), our ruling in connection with the Puerto Rico income tax treatment of the transaction described below under the provisions of the Puerto Rico Internal Revenue Code of 2011, as amended (“Code”).

I. STATEMENT OF FACTS

Taxpayer D is a bonafide resident of Puerto Rico. He was granted a Tax Exemption Grant under Act No. 22 of January 17, 2012 (“Act 22-2012”). A non-Puerto Rico grantor trust, whose beneficiaries and grantors are the Taxpayers, is the sole stockholder of Corporation F. Taxpayer D is married to Taxpayer E (Taxpayer D and Taxpayer E are collectively referred to as the “Taxpayers”).

Taxpayer E is a bonafide resident of Puerto Rico. Taxpayer E was also granted a Tax Exemption Grant under Act 22-2012.

You also represented that Partnership is a legal entity organized outside Puerto Rico that is not engaged in a trade or business in Puerto Rico. Partnership is owned by two members. K, a non-Puerto Rico entity that is not doing business in Puerto Rico and has been treated as a partnership for federal income tax purposes, is the owner of 80% of Partnership. K, in turn, is owned by a non-Puerto Rico grantor trust, whose beneficiaries and grantors are the Taxpayers.

It was further represented that on November 7, 2003, Partnership acquired an Asset for \$X,XXX,XXX. Additional investments in the Asset were made in 2007 through 2015, in a total amount of \$XXX,XXX. The Partnership has claimed depreciation deductions on the Asset for federal income tax purposes in an amount close to 99% of the total cost. No depreciation deduction has been claimed for Puerto Rico income tax purposes. The Partnership is planning to sell the Asset at its fair market value, which is estimated to be

approximately 21% of the total cost. Therefore, the amount the Partnership expects to receive upon the sale of the Asset is significantly lower than the depreciation deduction claimed for federal income tax purposes.

II. RULING REQUESTED

To the extent that the amount realized on the sale of the Asset is lower than the depreciation claimed with respect to such Asset for federal income tax purposes, any income or gain derived from the sale of the Asset will be treated as income from sources outside of Puerto Rico, pursuant to Section 1035.03(c) of the 2011 Code. Therefore, subject to the limitations under Section 1051.01 of the 2011 Code, the Taxpayers will be entitled to claim a foreign tax credit against Puerto Rico income taxes with respect to the federal income tax paid in connection with the sale of the Asset.

III. LAW AND ANALYSIS

Section 1035.01(a)(6) of the Code provides that Sections 1035.03, 1035.04, and 1035.05 shall be applicable to the gains, earnings, and income from the sale of personal property.

Section 1035.03(a)(1) of the Code provides, in part, that any gains, earnings, or income derived from the sale or exchange of personal property by a resident individual constitutes income from sources within Puerto Rico. However, Section 1035.03(c) of the Code provides that the amount of any gains, earnings, or income derived from the sale or exchange of personal property shall be attributable to income from sources within and without Puerto Rico. In computing the amount to be considered as income from sources within Puerto Rico, there shall be compared the proportion that the Puerto Rico current depreciation adjustments claimed (or claimable) with respect to such property under Section 1034.02(b)(1)(B) of the Code, bears to its total depreciation adjustments.

No regulations have been issued under Section 1035.03 of the Code.

Section 1051.01(a)(1) of the Code provides, in part, for a credit against the income taxes imposed under Subtitle A, determined by any income and excess benefits taxes paid or accrued to the United States during the taxable year, within the following limits stated in Section 1051.01(b):

- In the case of a taxpayer that is not a corporation, the amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within said country bears to his entire net income for the same taxable year; and
- In the case of a taxpayer that is not a corporation, the total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources without Puerto Rico bears to his entire net income for the same taxable year.

IV. CONCLUSION

Based solely on the facts and representations submitted for our consideration, the provisions of the Code, and the applicable Regulations, this Department rules that:

1. Pursuant to the provisions of Section 1035.03(c) of the Code, and to the extent that the amount realized on the sale of the Asset is lower than the depreciation claimed with respect to such Asset for federal income tax purposes, any income or gain derived from the sale of the Asset will be treated as income from sources outside of Puerto Rico.
2. Subject to the limitations provided under Section 1051.01 of the 2011 Code, the Taxpayers will be entitled to claim a foreign tax credit against Puerto Rico income taxes with respect to the federal income tax paid in connection with the sale of the Asset.

No opinion is expressed as to the tax treatment of the above transaction under any other provision of the Code and the applicable regulations, or as to the tax treatment of any condition existing at the time of the transaction, or any effect resulting therefrom, that is not specifically covered by this letter. The opinion expressed herein shall be valid only upon the continued existence of the facts, as submitted for our consideration. This ruling letter is directed only to the Taxpayers requesting it and may not be used or cited as precedent.

Cordially,

Elisa Vélez Pérez
Assistant Secretary