



GOVERNMENT OF PUERTO RICO

Department of the Treasury

May 8, 2017

ADMINISTRATIVE DETERMINATION NO. 17-02

ATTENTION: TAXPAYERS ENGAGED IN PASSENGER AND CARGO AIR AND MARITIME TRANSPORTATION DOING BUSINESS IN PUERTO RICO

SUBJECT: COMPUTATION OF THE NET TAXABLE INCOME UNDER THE PROVISIONS OF THE PUERTO RICO INTERNAL REVENUE CODE OF 2011, AS AMENDED

I. Statement of Motives

Section 1035.07 of the Puerto Rico Internal Revenue Code of 2011, as amended ("Code") establishes the rules to be followed in the determination of the Puerto Rico source income for taxpayers engaged in the air and maritime transportation industry. Many taxpayers in this industry have brought to our attention certain provisions of the Code related with the determination of the net income subject to tax in Puerto Rico that the Puerto Rico Treasury Department ("Department") should clarify, as they could result in the imposition of taxes on income from sources outside of Puerto Rico.

Based on the above, the purpose of this Administrative Determination is to clarify the Department's position regarding the determination of the net income subject to tax in Puerto Rico of taxpayers engaged in trade or business in Puerto Rico in the passenger and cargo maritime or air transportation business, according to Section 1035.07 of the Code.

II. Statutory Basis

As a general rule, Section 1035.07 of the Code provides that *all* income from transportation that begins *and* ends in Puerto Rico is considered as derived entirely from sources within Puerto Rico. On the other hand, income from transportation that begins *or* ends in Puerto Rico is considered fifty percent (50%) attributable to sources within Puerto Rico.

For purposes of Section 1035.07 of the Code, subsection (d) defines "transportation income" as any gain, profit or income derived from, or related with the use or lease of a vessel or aircraft used in the rendering of transportation services or the performance of services directly related to the use of a vessel or aircraft.

Additionally, Section 1033.17(a)(17) of the Code, provides that fifty-one percent (51%) of the expenses incurred by a taxpayer and paid or to be paid to: (i) a related person not



engaged in a trade or business in Puerto Rico, if such expenses are attributable to the conduct of a trade or business in Puerto Rico and not subject to tax or withholding at source under the Code in the taxable year in which they were incurred or paid, or (ii) a home office located outside of Puerto Rico, by a foreign corporation engaged in trade or business in Puerto Rico through a branch, are not allowed as deductions in computing the net taxable income.

Both, Section 1035.07 as well as Section 1033.17(a)(17) of the Code, establish limitations on the amount of expenses that can be allocated in determining net income subject to tax in Puerto Rico.

III. Determination

Section 1035.07 of the Code does not provide guidance for businesses that are engaged in the transportation industry in connection with which expenses are allowed as a deduction against the transportation income to determine the *net income* subject to tax in Puerto Rico. Notwithstanding, a consistent treatment as the one used to determine the source of the transportation income, pursuant to Section 1035.07 of the Code, should be provided to the expenses related to such income. Therefore, the Department herein determines that the expenses related with the generation of the “transportation income” should be treated likewise under the fifty percent (50%) income source rule and should be attributed in this same proportion to the Puerto Rico source income. This will be construed as the definition of “net income” from transportation services under the Code. Consequently, for purposes of computing the Puerto Rico source *net income* of taxpayers engaged in the transportation industry, the expenses related with the transportation service will be allowed, subject to the same rules established under Section 1035.07(a) and (b) of the Code. However, other allocated expenses *unrelated* with the transportation services considered as Puerto Rico source income, pursuant to Section 1035.07(a) and (b) of the Code, will not be allowed unless these expenses can be related with income subject to tax in Puerto Rico.

On the other hand, with regards to the fifty-one percent (51%) disallowance under Section 1033.17(a)(17) of the Code, the special rule of Section 1035.07(b) of the Code, which is specific to the transportation industry, should prevail over any other section of the Code to avoid duplicate limitations. Therefore, in the case of air and maritime cargo and passenger transportation business pursuant to Section 1035.07(b) of the Code, the Department determines that the limitation established by Section 1033.17(a)(17) of the Code shall not be applicable, exclusively in those cases in which only fifty percent (50%) of the income and fifty percent (50%) of the corresponding expenses, are attributed to sources within Puerto Rico.

The above determinations are effective for taxable years beginning after December 31, 2015. Those taxpayers that, at the date of issuance of this Administrative Determination, have already filed their Income Tax Return for taxable year 2016, may request to the Department a Closing Agreement, in accordance with Tax Policy Circular Letter No. 14-01 of August 28, 2014, or a Ruling, pursuant to Tax Policy Circular Letter No. 16-09 of December 29, 2016, subject to the provisions of the Code and the terms established under



Regulation No. 8693 of January 26, 2016, in order to clarify any issue that may arise from this Administrative Determination and the amounts reported in said Income Tax Return.

IV. Effectiveness

The provisions of this Administrative Determination are effective immediately and are applicable to taxable years beginning after December 31, 2015.

For additional information regarding the provisions of this Administrative Determination, you may contact us at (787) 622-0123, option number 8.

Cordially,



Raúl Maldonado Gautier, Esq., CPA
Secretary of Treasury

