

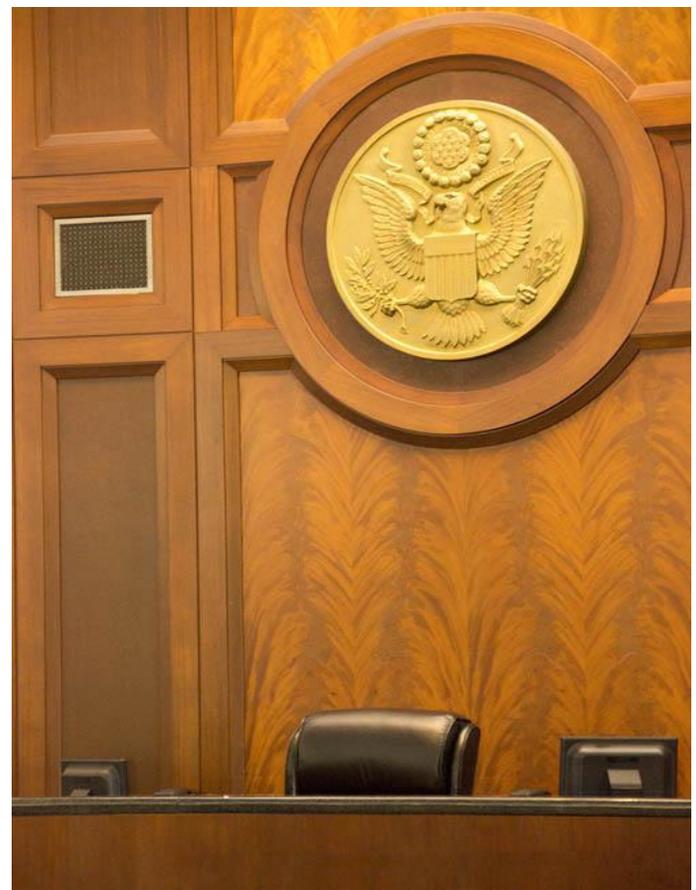
TAX NEWSLETTER

U.S. DISTRICT COURT RULES IN FAVOR OF WAL-MART PUERTO RICO, INC. IN ITS CASE AGAINST THE TREASURY DEPARTMENT OF THE COMMONWEALTH OF PUERTO RICO

ACT NO. 72-2015

Act No. 72 of May 29, 2015 (“Act 72-2015”) amended the Internal Revenue Code for a New Puerto Rico, Act No. 1 of January 31, 2011, as amended, (the “IRCPR”) to, among others, increase from 2% to 6.5% the corporate alternative minimum tax (“AMT”) rate. This amendment applies to purchases between related parties in transactions involving an out-of-state home office or any related party.

One of the Commonwealth’s arguments to justify the increase was that the acquisition of goods between related entities is a means to shift profits between jurisdictions through the use of the “transfer pricing rules”. Thus, the amendments brought by Act 72-2015 were intended to correct perceived abuses through the use of transfer pricing practices among related entities.



THE CASE

As a result of the amendments enacted under Act 72-2015, Wal-Mart Puerto Rico, Inc. (“Wal-Mart PR”) estimated that its effective income tax rate for the following six years would be in excess of 100% of its net taxable income. Hence, Wal-Mart PR sought relief against the enforcement of the AMT and a declaration that the AMT is unlawful under the dormant Commerce Clause, the Equal Protection Clause and the Bill of Attainder Clause of the United States Constitution, and under the Federal Relations Act.

THE DECISION

In a [decision](#) entered on March 28, 2016, the United States District Court for the District of Puerto Rico (the “Court”) ruled that:

- The Court has subject-matter jurisdiction over the controversy under the Butler Act;
- The AMT violates the Dormant Commerce Clause, the Federal Relations Act, Equal Protection Clause; and,
- The AMT does not violate the Bill of Attainder Clauses.



Subject-matter jurisdiction

The Court construed the Butler as requiring two conditions that must be satisfied in order to deprive a federal court of jurisdiction: 1) the suit must attempt to restrain the assessment or collection of a Commonwealth tax; and, 2) local courts must provide plaintiff a plain, speedy, and efficient remedy.

In the present case, both parties agreed that the action’s purpose was to enjoin a Commonwealth tax. Thus, the remaining question was whether the statutory and procedural mechanisms available to Wal-Mart PR under Commonwealth law allow for a plain, speedy, and efficient remedy. The Court concluded that due to the Commonwealth’s dire economic situation and its insolvency, its Treasury Department cannot be counted on to refund the significant amount of AMT taxes that Wal-Mart PR would have to pay under the AMT amendments if these were eventually declared unconstitutional by the Puerto Rico Courts. The Court concluded that the local remedy is ineffective and, as a result, the Court found that it had subject-matter jurisdiction over the controversy under the Butler Act.

The Commerce Clause

Since the AMT component in question is only applicable where the seller or transferor is not subject to the Commonwealth income taxes on the transaction but the buyer is, the Court found that the AMT is discriminatory and, thus, violates the dormant commerce clause. A state tax cannot limit the application of its taxes to cross-border sales or transfers by an out-of state company to its local branch office or affiliate.

The Federal Relations Act

Pursuant to the Federal Relations Act, the Commonwealth may levy taxes on articles, provided that such taxes do not discriminate between articles imported from the United States or foreign countries and similar articles produced or manufactured locally. The Court found that the AMT amendments violate the Federal Relations Act since its practical effect is the economic protection of goods produced or manufactured locally.

The Equal Protection Clause

The Court found that the AMT violates the Equal Protection Clause as it was deemed both arbitrary and not rationally connected to a legitimate governmental purpose. It found that the same do not bear any relationship to proper measures of profit or income and that it has nothing to do with identifying or curing problematic instances of “transfer pricing”.

The Court held that the AMT violates the Equal Protection Clause because it discriminates against multistate businesses engaging in interstate transactions; finding it arbitrary and serving no legitimate state purpose.

The Bill of Attainder Clause

A bill of attainder refers to a priori determination of guilt and infliction of punishment without basis and particularly without the benefit of a judicial determination. In the present case, the Secretary of the Treasury Department testified that the Department had no reason to believe that Wal-Mart PR had been using any base erosion techniques or inflated transfer pricing either to shift profits off of the island or to evade local taxes. Any such accusations against Wal-Mart PR, said the Court, appear to be baseless. Therefore, the Court found that the AMT does not constitute a punishment to Wal-Mart PR but merely opportunism on the part of the Commonwealth to raise cash in light of its dire economic situation.

CONCLUSION

In sum, in a 109 pages opinion, Judge Fusté invalidated that portion of the corporate AMT provisions in the IRCPR based on purchases between an out-of-state home office or related party. As a result, the Puerto Rico Secretary of the Treasury of the Commonwealth is estopped from levying, collecting and enforcing the enjoined subsections of the AMT, including the corresponding estimated tax payments provisions.

The Governor of the Commonwealth has already indicated that the Court’s decision will be appealed.

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