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GUIDE

PUERTO RICO EXECUTIVES TRAVELING TO US



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PUERTO RICO TAX COMPLIANCE GUIDE

By Torres CPA Group
CifrasPR

Understanding the Puerto Rico tax system and its interrelation with United States is crucial for individuals and entities doing business in Puerto Rico. Puerto Rico is not a state; its's a territory, with its own Business and Payroll laws and regulations.

The following White Pater is designed to give an insight Tax Issues in Puerto Rico. It provides relevant background information, which will be of assistance to organizations considering establishing business in the Island. Nonetheless, it is highly recommended to seek advice and counsel from qualified professional sources before undertaking any business.

Certain exclusions and exemptions may apply and when specific problems occur in practice, it will often be necessary to refer to the laws and regulations of Puerto Rico, and to obtain appropriate accounting and legal advice.

It is understood that the following overview does not constitute any formal rendering of either legal, accounting, tax or professional services. If legal advice or other assistance is required, an attorney, CPA or tax adviser should be consulted.

Torres CPA Group is an Advice Certified Public Accounting Firm offering Audit, Tax, Consulting and Financial Outsourcing services for over 30 years. If you require any further information or help, please do not hesitate to contact us.

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Stewardship Taxable issues of Puerto Rico Executives Traveling to the US

Clients, senior management, directors, and officers may spend a significant amount of time in the United States to effectively oversee business operations and achieve desired synergies.

The US Internal Revenue Service (IRS) may opt to increase the scrutiny to determine whether this type of cross-border activity by senior executives and employees creates a taxable presence in the United States for Puerto Rico companies, a foreign entity under the US code.

Stewardship

The fact that an activity of a Puerto Rico entity is carried out through a fixed place in the United States does not mean that it is a business activity of the Puerto Rico entity. Example 2 under Treas. Reg. § 1.864-3(b) provides that certain limited activities that could be carried out by a foreign executive in the United States should not give rise to a US Trade or Business (USTB).

To rise to the level of a USTB, a profit-oriented activity within the US generally must be more than merely ministerial, clerical, or passive in nature. Generally, it must be recurring, as opposed to an isolated activity.

Puerto Rico entities are considered foreign with in the IRS tax code.

Relevant Rulings

For a foreign corporation to be subject to the US corporate income tax, it is sometimes required that the corporation is engaged in trade or business in the United States.

Whether a foreign corporation has a USTB is determined by considering a related entity's activities or its agents in the United States.

Though there is no codified definition of what activities give rise to a USTB, a corporation that engages in profit-oriented activities that are "considerable, continuous, and regular" in the United States may be deemed to have a USTB whether or not it has an office or other fixed place of business in the United States.

The definition of a PE is commonly understood to be narrower in scope than that of a USTB as the term 'permanent establishment' includes a place of management. US IRS generally defines a PE as a "fixed place of business through which the business of an enterprise is wholly or partly carried on." Thus, a foreign enterprise generally creates a US PE by having a fixed place of business in the United States available to conduct its business activities.

Even in the absence of such a fixed place of business, it might cause the US activities of an agent of the corporation to constitute a US PE of the corporation, but only if the agent has and habitually exercises in the United States, an authority to conclude contracts in the name of the corporation, and not if the agent is of an independent status and acting in the ordinary course of his business as an agent.

Executive for both US and Puerto Rico Entities

Based on the example described under Treas. Reg. § 1.864-3(b), a CEO of a Puerto Rico company could also act as the CEO of one of the company's US entities and "spends a substantial portion of the taxable year" in the United States both supervising the Puerto Rico company's investment in its operating US entity and acting as CEO of the US entity.

The Puerto Rico entity "is not considered to be engaged in doing business in the US during the taxable year because of the activities carried on in the United States by its chief executive officer in the supervision of its investment in its operating entities."

While performing ownership-type functions concerning an entity is not a "business" activity, however the example does not address other types of income generating executive or management activities, such as the Puerto Rico entity's marketing activities.

It is increasingly common for one executive to manage both US and PR (foreign) business operations. For example, a Puerto Rico entity expanding its distribution into the United States may appoint its head of marketing to act as CEO of the US entity, with 50 percent of the executive's time being spent on branding for the Puerto Rico entity and the remaining 50 percent spent on business stewardship operations of the US entity, both roles being performed, in part, at the offices of the US entity. In this case, there may be a high risk that the Puerto Rico entity has a presence in this scenario.

Periodic Management Visits

One of the most common situations involving cross-border executive management from a foreign company by periodically visiting its US entity to perform stewardship and high-



level operational support activities (e.g., general oversight and training), or business administration (e.g., regulatory requirements and human resources).

Visiting personnel is generally given plenary access to the US entity's offices as well as dedicated office space. When such executives are in the United States they continue to perform operational and management duties on behalf of and for the benefit of the foreign entity.

Even though the Puerto Rico executives in this scenario may not create a trade or business since they are not soliciting or negotiating sales contracts, they might risk creating a "fixed place of business" PE or a "place of management" PE if their presence is sufficiently sustained.

Not only do the Puerto Rico executives have unfettered access to the US offices, but they may also perform management activities critical to the Puerto Rico entity's business operations that go well beyond mere "preparatory or auxiliary" activities.

Mitigating Exposure

It is easy to see how executives present in or regularly traveling to the United States could run the risk of triggering a US Trade or Business or creating a US Permanent Location. Such executives often have access to the US offices of a US entity and, considering their management role in the Puerto Rico entity, may have express contractual authority.

Thus, Puerto Rico companies with senior management, directors, or officers spending significant amounts of time in the United States should take a closer look at the activities of management and may find it helpful to set up operating protocols limiting such activities to avoid inadvertently establishing a taxable presence in the United States.