



# TaxNewsFlash

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## Notice 2022-42: Intent to amend noncompulsory payment regulations under section 901 with respect to amended Puerto Rico tax decrees

The IRS today released an advance version of [Notice 2022-42](#) [PDF 64 KB] announcing that the Treasury Department and the IRS intend to amend the regulations under section 901 with respect to the application of the noncompulsory payment regulations to certain amended Puerto Rico tax decrees.

### **Background and explanation of forthcoming amendment**

Notice 2022-42 states that the Treasury Department and the IRS are aware that certain U.S. taxpayers with operations in Puerto Rico (including operations conducted indirectly through subsidiaries or other affiliates) have negotiated long-term tax agreements with Puerto Rico, known as tax decrees, that provide more favorable tax treatment than under the generally applicable Puerto Rico tax laws. Among other benefits, these tax decrees provide for reduced rates of tax levied on U.S. taxpayers and their affiliates performing certain activities in Puerto Rico. However, the tax decrees do not modify the application of the certain modified effectively connected income (ECI) rules under Puerto Rico's tax laws that impose a tax on income deemed to be earned in connection with a Puerto Rico trade or business. Similarly, the tax decrees do not modify the application of the excise tax on the acquisition of certain personal property manufactured or produced in Puerto Rico and amounts paid for certain services performed in Puerto.

Final regulations under sections 901 and 903 were issued on December 28, 2021, that provide that a foreign tax imposed on a nonresident is a foreign income tax for which a credit is allowable only if the tax is based on (1) the nonresident's activities in the taxing jurisdiction, (2) income properly sourced to the taxing jurisdiction, or (3) the sale or exchange of certain property located in the taxing jurisdiction. Under those final regulations, Puerto Rico's modified ECI tax and the excise tax do not constitute foreign income taxes. Therefore, a credit would not be allowed for those taxes under section 901. Those final regulations apply to any modified ECI tax and excise tax paid or accrued (depending on the taxpayer's method of accounting for foreign income taxes) in taxable years beginning on or after January 1, 2023.

Act 52-2022—enacted into law in Puerto Rico on June 30, 2022—allows taxpayers to amend their existing tax decrees to replace the existing income tax and royalty withholding tax framework with a new income tax and royalty withholding tax framework. If a taxpayer elects to amend an existing tax decree, the remaining term of the amended tax decree is extended by 15 years. Taxpayers that opt to amend their existing tax decrees pursuant to Act 52-2022 are no longer subject to the modified ECI tax and the excise tax. In certain cases, the decision to amend an existing tax decree pursuant to Act 52-2022 may result in a U.S. taxpayer and/or one or more of its affiliates owing a greater total amount of tax to Puerto Rico than would be owed absent the amendment. However, the terms of the amended tax decrees are expected to result in taxes imposed at rates lower than those under the generally applicable Puerto Rico income tax laws absent any decree.

Treas. Reg. §1.901-2(e)(5)(i) provides that an amount remitted to a foreign country is not a compulsory payment, and thus is not an amount of foreign income tax paid, to the extent that the amount remitted exceeds the amount of the taxpayer’s liability for foreign income tax under the foreign tax law (the “noncompulsory payment regulations”). Treas. Reg. §1.901-2(e)(5)(iii)(A) provides that where foreign tax law provides a taxpayer with options or elections in computing its liability for foreign income tax whereby a taxpayer’s foreign income tax liability may be permanently decreased in the aggregate over time, the taxpayer’s failure to use such options or elections results in a foreign payment in excess of the taxpayer’s liability for foreign income tax.

To facilitate Puerto Rico’s transition to Act 52-2022, and given Puerto Rico’s status as a territory of the United States, the Treasury Department and the IRS announced in Notice 2022-42 that it is necessary and appropriate to provide guidance on the application of Treas. Reg. §1.901-2(e)(5) to amounts remitted to Puerto Rico under the terms of a tax decree amended pursuant to Act 52-2022 on or before December 31, 2022. Therefore, the Treasury Department and the IRS intend to issue regulations under section 901 (the “forthcoming proposed regulations”) to provide that amending an existing tax decree pursuant to Act 52-2022 (as enacted on June 30, 2022) will not, solely by reason of any difference in the amount of income tax liability to Puerto Rico under the existing tax decree as compared with the amended tax decree, be considered to increase the taxpayer’s liability for Puerto Rico income tax over time for purposes of Treas. Reg. §1.901-2(e)(5) if the existing tax decree is amended pursuant to Act 52-2022 on or before December 31, 2022, and the taxpayer’s Puerto Rico income tax liability under the amended tax decree in each taxable year is less than the amount of income tax the taxpayer would have owed to Puerto Rico under Puerto Rico’s generally applicable income tax laws in the absence of any tax decree in the taxable year.

### **Taxpayer reliance and request for comments**

The forthcoming proposed regulations will provide that the rules set forth in Notice 2022-42 apply to taxable years ending on or after October 11, 2022. Until the date of issuance of the forthcoming proposed regulations, taxpayers may rely on the rules set forth in Notice 2022-42.

The Treasury Department and the IRS invite comments on the forthcoming proposed regulations. Written or electronic comments must be received by January 9, 2023.

Notice 2022-42 also revokes Notice 2011-29, effective for excise tax paid or accrued in taxable years beginning on or after January 1, 2023.

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