Zaragoza Alvarado
Taxand

The Tax Advisor

Special Bulletin

October, 2012

The Municipal Revenue Collection Center Clarifies the Taxation of Inventory Held in Foreign Trade Zones

Author

Corali del Llano
Manager

787-999-3011
cllano@zatax.com

Tax is our business®

In August 10, 2012, the Municipal Revenue Collection Center ("MRCC") filed Regulation No. 8241 with the Department of State. The purpose of this Regulation is to amend Article 3, Subsection C of Regulation No. 7049, known as the Regulation to Impose Personal Property Taxes, to clarify the taxation of inventory held in a Foreign Trade Zone ("FTZ") provided in the Property Tax Act, as amended. In this issue, we will discuss the nature and background of the FTZs and the federal tax exemption on inventory, the local exemption provided in the Property Tax Act, the conflict with Regulation No. 7049, and the new position adopted by the MRCC in Regulation No. 8241.

FTZs and the Exemption from Ad Valorem Taxation

FTZs were first authorized in 1934 by enactment of the FTZ Act, to promote the international trade. These zones are designated geographic areas in the United States, District of Columbia and Puerto Rico which, for purposes of customs and tariff laws, are treated as if they were located outside the United States. This allows businesses to realize substantial tax and duty benefits including the deferral or elimination of duties and, exemption from state and local property tax.

Particularly, the exemption from state and local property taxes was introduced by an amendment enacted in 1984. As expressed in the Report presented by the Senate of the United States, the purpose of the amendment was to make it clear that imported goods held in a FTZ and produced goods in the United States for exportation would be exempt from state and local ad valorem taxation.

The 1984 amendment added a subsection to the FTZ Act to provide that "[t]angible personal property imported from outside the United States and held in a zone for the purpose of storage, sale, exhibition, repackaging, assembly, distribution, sorting, grading, cleaning, mixing, display, manufacturing, or processing, and tangible personal property produced in the United States and held in a zone ***for exportation***, either in its original form or as altered by any of the above processes, shall be exempt from State and local ad valorem taxation." (emphasis ours).

FTZ Exemption in Puerto Rico

Notwithstanding the clear and preemptive language of the ad valorem tax exemption in the FTZ Act, for various years the

Continues on Page 2

The Municipal Revenue… Continued from Page 1

Personal Property Tax Act remained silent and companies operating within FTZs in Puerto Rico were concerned with the possible imposition of personal property taxes by the MRCC on the inventory held in a FTZ. Finally, 20 years later, Act No. 159-2004, amended Section 5.01 of the Property Tax Act (the "2004 Amendment") to provide an exemption from personal property taxes on the personal property, including inventory and equipment, of those businesses that maintain operations within a FTZ or Subzone in Puerto Rico, duly accredited pursuant to the FTZ Act.

Upon review of the 2004 Amendment, it may be noted that its language provides a broader exemption than the exemption in the FTZ Act. The FTZ exemption incorporated into the local Property Tax Act provided an exemption for all inventory and equipment located in a FTZ. No distinction was made upon the origin of the personal property or its final destination.

The Conflict: MRCC's Former Position

During discussions regarding the 2004 Amendment to incorporate the FTZ exemption into the Personal Property Tax Act, the MRCC timely expressed its opposition to the enactment of the exemption as drafted. The MRCC commented that the language of the proposed amendment provided a broader exemption on personal property tax as compared to the federal exemption, since it was being extended to goods held in the FTZ even though the goods were not identified or marked as goods for export. The MRCC was concerned with the possibility of companies conducting activities in a FTZ and holding inventory destined for local commerce until it was sold, as a mechanism to avoid the imposition of the personal property tax on inventory. Notwithstanding the MRCC's opposition to the Amendment, the broader exemption was enacted.

On November 10, 2005, approximately one year after the enactment of the 2004 Amendment, the MRCC filed with the Department of State Regulation No. 7049, known as the Regulation to Impose Tax on Personal Property (the "Regulation"). The FTZ exemption on inventory was incorporated in Article 3, Subsection C, but the language included in the Regulation was very similar to the language of the more restrictive federal FTZ exemption, since it required the goods to be held in the zone for exportation. Furthermore, the Regulation required taxpayers to file a sworn statement declaring they did not maintain other warehouse facilities and that none of the goods for which the exemption was claimed represented inventory to be sold in Puerto Rico. Clearly, the language of the Regulation was not consistent with the provision of the Personal Property Tax Act.

Following the adoption of the Regulation, on May 3, 2006, the MRCC Executive Director addressed a communication to the Puerto Rico Society of Certified Public Accountants clarifying the MRCC's position regarding the federal and the local exemption on inventory. In this letter, it was clearly established that the exemption under the provisions of the FTZ Act was not going to be granted by the MRCC to personal property exiting the FTZ and entering United States territory.

Clarification: Regulation No. 8241

After years of uncertainty and conflict between the Regulation and the Personal Property Tax Act, the MRCC made a ninety (90) degree turn, and modified its position regarding the FTZ exemption on inventory. On August 10, 2012, the MRCC filed Regulation No. 8241 with the Department of State.

The purpose of this Regulation is to accommodate the provisions of Regulation No. 7049 to the language of the FTZ exemption on inventory provided by the Personal Property Tax Act, as amended by Act No. 159-2004. The MRCC recognized that the language of the exemption included in the Personal Property Tax Act is clear, and that nowhere in the statute it is required that the inventory should be marked for exportation for the exemption to apply. The MRCC recognized that in order to comply with current state of law, it is the MRCC's duty to repeal provisions of Regulation No. 7049 which are in conflict with the clear language of the statute.

In summary, Regulation No. 8241 amended Regulation No. 7049 to:

1. eliminate the requirement that inventory should be exported for the exemption to apply and;

2. eliminate the requirement of filing a

Continues on Page 3

Key Contacts at Zaragoza & Alvarado LLP:

Juan Zaragoza, CPA
Managing Partner
787-620-7740
jzaragoza@zatax.com

Juan Alvarado, Esq., CPA
Partner
787-620-7730
jalvarado@zatax.com

Felipe Mariani, CPA
Partner
787-620-7736
fmariani@zatax.com

Sandra Marie Torres, CPA
Partner
787-620-7728
storres@zatax.com

Edgardo Sanabria, CPA
Partner
787-999-3015
esanabria@zatax.com

Carlos R. González, CPA
Partner
787-620-7729
cgonzalez@zatax.com

104 Acuarela Marginal St.
Martínez Nadal Expressway
Guaynabo PR 00969

PO Box 195598
San Juan PR 00919-5598

The Municipal Revenue… Continued from Page 2

sworn statement declaring the inexistence of other warehouse facilities and that none of the goods for which the exemption was claimed represented inventory to be sold in Puerto Rico.

Z&A Comments

Uncertainty regarding the taxation of inventory held in FTZs has come to an end and businesses engaged in operations in FTZs may now have some peace of mind regarding this issue. It is now clear that inventory held in the FTZ will be exempt from the imposition of personal property tax, notwithstanding its final destination. However, this bliss may be short lived. In anticipation to the 2012 general elections, various political parties have included the elimination and or modification of the personal property tax as part of their political platforms. In the event that one of these parties is elected and the contribution on personal property tax, as we know it, is eliminated or modified, the benefits of the FTZ exemption on inventory may disappear.

This may not be that bad after all since no personal property tax would be paid on the inventory under that scenario. However, all political parties have made it clear that the elimination of the personal property tax (in all or in part) may not signify the reduction of the revenues collected by the Municipalities. Therefore, an increase in the tax rates of another municipal tax or an enactment of a completely new municipal tax should be expected. Since none of these municipal taxes will be a property tax on inventory, those companies enjoying a personal property tax exemption due to the FTZ may end up paying a higher amount in taxes.