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"We are what we repeatedly do. Excellence therefore, is not an act, but a habit." - Aristotle

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EL FIDEICOMISO DE GARANTÍA: PROPUESTA PARA UNA NUEVA HERRAMIENTA PARA ASEGURAR EL CUMPLIMIENTO DE OBLIGACIONES EN PUERTO RICO E IMPULSAR EL TRÁFICO JURÍDICO MERCANTIL

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I. EL FIDEICOMISO DE GARANTÍA: SU FUNCIÓN Y SUS ORÍGENES

El fideicomiso de garantía es una variante de la figura del fideicomiso cuyo objetivo es servir de garantía en la satisfacción de créditos obligacionales. El concepto se desarrolló tanto en los países de tradición civilista como en las naciones que se rigen por el derecho común. En el derecho civilista, el fideicomiso de garantía encuentra sus antecedentes en el derecho romano.[1] Comenzó su desarrollo como diferentes variantes de la figura del fideicomiso. Una de éstas, denominada *fiducia cum creditore contracta*, funcionaba como un contrato en el cual el deudor, o su agente, transmitían la propiedad de una cosa al acreedor para que éste la retuviera como garantía del cumplimiento de una obligación. Al extinguir la misma, el acreedor devolvía el bien. En otra de sus vertientes, conocida como *fiducia cum amico contracta*, el contrato establecía que el fiduciario transmitiría la propiedad a un fiduciario quien la ejercería en beneficio del transmitente. Por otro lado, en el derecho común encontramos que se desarrolló el mismo concepto pero a través de una historia diferente aunque paralela.[2] En los años luego de la conquista de las islas Británicas por los normandos, se desarrolló el *trust*, o fideicomiso, bajo la figura de los *uses*. En el *trust*, un sujeto transmitía bienes muebles o inmuebles a un tercero de confianza para que los manejara en beneficio del transmitente o de otra persona.

II. EL TRÁFICO MERCANTIL Y EL CONCEPTO Y FUNCIÓN DE LAS GARANTÍAS

[1] Julio César D. Fernández, *Antecedentes Históricos del Fideicomiso*, *en* I TRATADO TEÓRICO PRÁCTICO DE FIDEICOMISO (Beatriz Maury de González ed., Ad Hoc, 2000).
[2] *Id.*

El comercio es el dínamo de las economías modernas. El ordenamiento jurídico lo reconoce y provee una serie de normas y figuras cuyo fin es aumentar la probabilidad de que las obligaciones generadas mediante el tráfico jurídico se satisfagan. Vélez Torres, uno de los exponentes más importantes del tema de las obligaciones en Puerto Rico, establece que "[e]l Derecho otorga al acreedor distintas acciones y prerrogativas para la protección, garantía y ejecución de su crédito".[3] Estas garantías, en esencia, son instrumentos que minimizan la incertidumbre, el riesgo y el costo que debe asumir un acreedor a la hora de extender un crédito.[4] Menor riesgo se traduce en menor costo y a su vez en mejores precios para aquellos sujetos que se convertirán en deudores. Lo que se busca es la existencia de mejores términos comerciales para la sociedad en general.

En Puerto Rico las principales garantías reconocidas por el ordenamiento jurídico incluyen la hipoteca, la prenda, la anticresis, las cláusulas penales y la garantía personal. Cada una ofrece ciertas ventajas y desventajas al acreedor dependiendo de la naturaleza del negocio. La hipoteca, por ejemplo, permite al acreedor la realización del valor de un bien inmueble hipotecado. La prenda le da el derecho al acreedor a garantizar el cumplimiento de una obligación con un bien mueble. La anticresis le permite al acreedor satisfacer su crédito de los frutos derivados del bien inmueble del deudor. La cláusula penal existe en el ámbito contractual y ofrece un incentivo al deudor a cumplir con lo pactado o, en su defecto, sufrir un deterioro en su patrimonio luego de un juicio. La garantía personal, finalmente, le permite al acreedor cobrar su crédito luego de un largo y costoso proceso judicial. El fideicomiso de garantía, por su parte, ofrece una nueva alternativa.

El fideicomiso de garantía juega un papel fundamental en las jurisdicciones que lo han incorporado al servir como una garantía de primer orden para asegurar el pago de todo tipo de obligaciones generadas en el tráfico jurídico. Esto es así porque se trata de una figura que no depende del sistema judicial para la realización del valor del bien garantizador sea este mueble o inmueble.

En nuestro ordenamiento jurídico, sin embargo, la figura es inexistente entre las herramientas que un acreedor tiene a su disposición para asegurar el cobro de su crédito. Esto es así porque en nuestra jurisdicción la ley de fideicomisos vigente no ofrece el marco procesal o sustantivo para el desarrollo de una garantía basada en la figura del fideicomiso. Esta situación debe corregirse lo antes posible mediante legislación que le supla una nueva vida a esta figura y permita el desarrollo del fideicomiso de garantía como una opción altamente eficiente en

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[3] JOSÉ RAMÓN VÉLEZ TORRES, DERECHO DE OBLIGACIONES 297 (2da ed., 1997).

[4] Laura Huertas Buraglia, *El Fideicomiso de Garantía: Características y Ventajas*, *en* EL FIDEICOMISO DE GARANTÍA 282 (Guillermo Cabanella de las Cuevas ed., 2008).

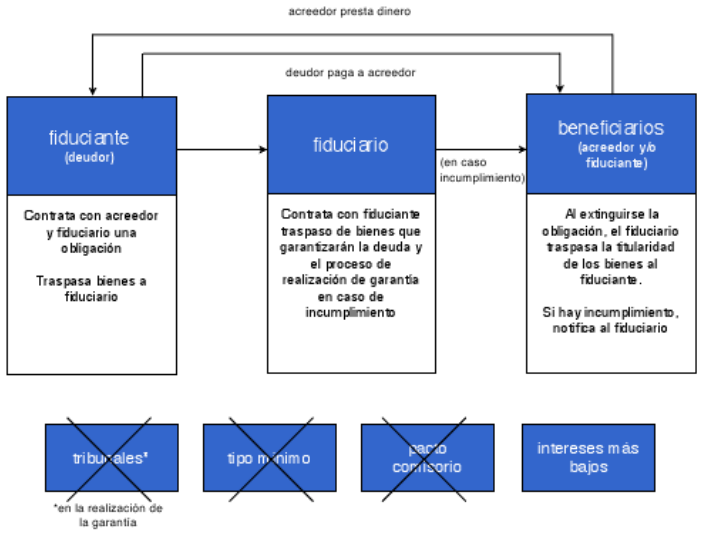
comparación a garantías tradicionales. Esta figura pudiese ser de mucha utilidad para ayudar al sector comercial local que sufre de altos costos operacionales como parte de la realización de valor de sus garantías tradicionales.

III. EL FIDEICOMISO DE GARANTÍA: DEFINICIÓN

El fideicomiso de garantía es:

> [U]n contrato[5] mediante el cual un fiduciante [transfiere] la propiedad de uno o más bienes a un fiduciario con la finalidad de garantizar con ellos, o con su producido, el cumplimiento de ciertas obligaciones a cargo de aquel o de un tercero, designando como beneficiario al acreedor o a un tercero en cuyo favor, en caso de incumplimiento, se pagará la obligación garantizada, según lo previsto en la convención fiduciaria y se entregará el sobrante, si alguno, al fideicomisario.[6]

Esquema típico de un fideicomiso de garantía



Las características más importantes del fideicomiso de garantía se discuten a continuación por separado.

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[5] En la literatura de fideicomisos existe un debate sobre la verdadera naturaleza del fideicomiso. Algunos escritores lo definen como un tipo de contrato mientras otros lo ven como una manera de traspasar la titularidad de un bien, etc. Para efectos de este trabajo, se tratará como un tipo de contrato, siguiendo la perspectiva de Kiper & Lisoprawski. CLAUDIO M. KIPER & SILVIO V. LISOPRAWSKI, TEORÍA Y PRÁCTICA DEL FIDEICOMISO (1999).

[6] KIPER & LISOPRAWSKI, *supra* nota 5, en la pág. 1.

A. Su naturaleza obligacional

El fideicomiso establece una relación de carácter obligacional entre el acreedor, el deudor y el fiduciario.[7] En esencia, como vimos anteriormente, lo que existe entre todas las partes es un contrato. La relación es obligacional ya que el deudor-fiduciante traspasa la titularidad del bien al fiduciario y en ningún momento se constituye un derecho real que le permita al deudor o al acreedor perseguir el bien. En otras palabras, el valor del bien garantiza el cumplimiento de la obligación pero el acreedor carece de toda facultad reipersecutoria sobre el mismo. En caso de incumplimiento, el acreedor sólo tiene derecho a exigir el cumplimiento de lo pactado con el fiduciario y el deudor. Esto es, la iniciación del proceso de liquidación del bien fideicomitido.

B. Multiplicidad de Patrimonios

Los bienes fideicomitidos, también denominados *corpus* del fideicomiso, existen en un patrimonio paralelo e independiente del patrimonio general del deudor y del fiduciario.[8] Esto quiere decir que los acreedores no tienen acceso a los mismos en caso de que cualquiera de los dos se declare en quiebra – excepto en caso de fraude. Su eventual reintegración al patrimonio general del deudor está sujeta a la condición resolutoria del cumplimiento de la obligación pactada. Conceptualmente, esta situación se asemeja a lo que ocurre con el heredero que acepta una herencia a beneficio de inventario: los bienes de la herencia no ingresarán al patrimonio del heredero hasta que se cumpla la condición.[9]

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[7] La naturaleza de la garantía resultante de un fideicomiso es algo que ha suscitado algún debate en la literatura. Los Dres. Osvaldo H. Soler y Enrique D. Carrica, por ejemplo, comentan sobre el tema que en Argentina "[n]o deja de advertirse, ante el silencio de la ley 24.441, que no trata ni regula las especies de fideicomiso ordinario, que queda pendiente de respuesta la pregunta sobre la naturaleza de la "garantía" que origina la que se analiza, y la del eventual privilegio que nazca de ella. Es evidente que no se genera un derecho real a favor del beneficiario o fideicomisario acreedor, como ocurre, por ejemplo, con la prenda o la hipoteca, teniendo aquél el derecho personal de exigir al fiduciario, en caso de incumplimiento del fiduciante deudor, que proceda a la venta o realización de los bienes o derechos fideicomitidos y con su producido se lo desinterese, pagándole su crédito. La efectiva y auténtica garantía, con el privilegio de cobro resultante, tendrían apoyo en las disposiciones de los arts. 14, primera parte, y 15 de la ley 24.441, pero no existen dudas que el problema debió y debe ser objeto de consideración y resolución legal, o por lo menos reglamentaria, correspondiendo dictar las normas pertinentes. (Énfasis en el original). *Véase* http://www.soler.com.ar/especiales/fideicomiso.htm (última visita 23 de abril de 2011).

[8] KIPER & LISOPRAWSKI, *supra* nota 5.

[9] Ver 31 LPRA §2801-2825.

C. Autoliquidación

Innegablemente la ventaja más importante que ofrece el fideicomiso de garantía al compararlo con garantías de otra naturaleza es la posibilidad de poder liquidar el mismo de manera independiente por la vía judicial en caso de incumplimiento. Al cumplirse las condiciones que constituyen un quebrantamiento de la obligación, el acreedor-beneficiario notifica al fiduciario, quien verifica el dato del incumplimiento y procede a implementar el proceso de realización de valor convenido con el deudor-fiduciante.[10] Siendo este acuerdo uno regido por la autonomía de la voluntad[11], no es necesario pedir la intervención de la Rama Judicial para conseguir el bien y vender el mismo para cubrir la obligación incurrida. Típicamente, el fiduciario procederá a tasar la propiedad para determinar su valor en el mercado en ese momento y gestionará la venta al mayor valor posible. Con el resultado de la compraventa, se liquidará la obligación y, de sobrar algún monto, se le entregará al deudor-fiduciante.

D. Pago preferencial

Gracias a que los bienes fideicomitidos existen en un patrimonio paralelo y separado al del deudor o fiduciario, los mismos no son susceptibles de ser sometidos a un procedimiento de quiebra. Esto redunda en una ventaja importante para los acreedores de los bienes fideicomitidos ya que sus créditos gozarán de pago preferencial sobre los demás acreedores del deudor.[12] La excepción, como mencionáramos anteriormente, sería cuando se ha fideicomitido un bien con el ánimo de defraudar a otros acreedores.

E. Flexibilidad

El fideicomiso de garantía se puede configurar de manera que sirva para la sindicación de acreedores y su rotación o subordinación sin necesidad de un costoso proceso de refinanciamiento. Mediante este sistema, los acreedores entran y salen del fideicomiso a medida que las obligaciones para con ellos son establecidas y extinguidas, todo en proporción al valor del *corpus*.[13]

El fideicomiso de garantía, además, se puede constituir mediante un contrato de adhesión re-configurable para el perfil de riesgo de cada deudor. Al igual que ocurre con los préstamos hipotecarios, los intereses para con los

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[10] FERNÁNDEZ, *supra* nota 1.
[11] 31 LPRA 3372.
[12] VÉLEZ TORRES, *supra* nota 3.
[13] HUERTAS BURAGLIA, *supra* nota 4.

fideicomisos de garantía reflejarían la probabilidad de incumplimiento de un deudor y ciertas decisiones de este último. A modo de ejemplo, un acreedor podría ofrecer un fideicomiso de garantía cuya definición de incumplimiento sea cuatro meses sin pagos (en vez de uno) antes de comenzar el proceso de liquidación. Ese tipo de acuerdo conllevaría un mayor interés por el mayor riesgo que asume el acreedor. Otro ejemplo que ilustra la flexibilidad de este instrumento es que las partes puedan pactar los términos en los cuales se revisará el contrato en caso que el patrimonio fideicomitido aumente en valor.

F. Naturaleza de los bienes fideicomitidos

El fideicomiso de garantía, asimismo, permite que los bienes fideicomitidos sean de cualquier naturaleza. No se trata de un crédito territorial sino de un instrumento mucho más flexible que permite fideicomitir bienes, ya sean muebles o inmuebles, de cualquier tipo.[14] Por ejemplo, se podría fideicomitir un flujo de efectivo, una corporación, unos derechos de autor, etc. Inclusive, los bienes fideicomitidos podrían mutar dentro del *corpus* y crear, a su vez, nuevos bienes. Por ejemplo, una corporación que se fusiona o consolida con otra, modifica sus operaciones y produce un nuevo tipo de producto.

G. Ausencia de pacto comisorio

Como vimos anteriormente, el fideicomiso de garantía se configura mediante el traspaso de un bien a un fiduciario que lo maneja en beneficios de un acreedor hasta que se extingue la obligación. En caso de incumplimiento, el fiduciario procede a realizar el valor de bien y con el ingreso resultante, salda la deuda. En ningún momento el acreedor puede tomar el bien para sí. En consecuencia, no existe la posibilidad de que se violente la prohibición contra el pacto comisorio. En este caso, la protección contra este tipo de pactos es mayor que en la hipoteca, la cual le permite al acreedor ingresar el bien a su patrimonio luego de una tercera subasta sin licitadores.

IV. EJEMPLOS DEL FIDEICOMISO DE GARANTÍA EN EL TRÁFICO MERCANTIL

A. Alternativa a la Hipoteca

La hipoteca es un derecho real de *realización* de valor. Esta realización, sin embargo, es una altamente costosa para todas las partes involucradas en dicho negocio jurídico toda vez que depende de un sistema

[14] VÉLEZ TORRES, *supra* nota 3.

judicial desprovisto de recursos para poder tramitar eficientemente los casos de ejecuciones. No es raro escuchar de ejecuciones donde el litigio toma varios años desde que se insta el pleito de ejecución hasta que se obtiene la sentencia correspondiente. A esto hay que añadirle los meses que transcurren desde que el deudor deja de pagar hasta que se radica la demanda, al igual que los meses que transcurren desde que la sentencia adviene final y firme hasta la subsiguiente subasta judicial y adjudicación de título. La Asociación de Banqueros Hipotecarios de Estados Unidos (MBA por sus siglas en inglés), estima que el costo de una ejecución de hipoteca para sus miembros ronda alrededor de los $50,000.00.[15] HSBC, uno de los bancos más grandes del mundo[16], estima que una ejecución en EEUU le cuesta al banco entre el 20% y el 25% del valor de la hipoteca.[17] Todos estos costos se traducen en intereses hipotecarios más altos para el consumidor o deudor hipotecario.

Para el consumidor existe un costo adicional desconocido por muchos hasta que es demasiado tarde: el tipo mínimo. Esta figura, que suple el precio mínimo al que saldrá a subasta el bien hipotecado, está definida de manera perjudicial para el consumidor al exigir que se utilice el valor que el bien tuvo al momento de constituir la hipoteca. Peor aún, si la primera subasta está desierta, el tipo mínimo se reduce a 2/3 del tipo mínimo original y eventualmente a 50%, si la segunda subasta se llegara a declarar desierta también.[18] En una economía inflacionaria, como es la norma en la mayoría de las economías modernas, esto quiere decir que la subasta empezará a un precio que pudiera estar muy por debajo del precio del mercado. Tomemos, como ejemplo, la subasta de una casa en Puerto Nuevo que fue tasada en $3,500.00 en la década del 1940 y 25 años después tasa $100,000.00. No sería difícil comprender como es muy posible que el deudor perdería gran parte del capital acumulado en la propiedad, el "equity", al pasar el bien por un proceso de subasta cuyo tipo mínimo será $3,500.00 y cuya subasta, típicamente, se llevará a cabo de manera rápida, con publicidad limitada y a través de un proceso que requiere grandes cantidades de fondos líquidos para poder licitar.

Frente a esta realidad, el fideicomiso de garantía provee una alternativa más eficiente. Esto, como ya hemos adelantado, gracias a que el fideicomiso de garantía no requiere la participación de un tribunal para

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[15] MORTGAGE BANKERS ASSOCIATION, LENDERS COST OF FORECLOSURE 2 (2008).
[16] HSBC Holdings PLC es una compañía de servicios financieros basada en Londres. En el año 2010 fue catalogada como el 6to grupo de servicios financieros, en tamaño, en el mundo por la revista Forbes. The Global 2000, FORBES, April 2, 2008.
[17] Mortage Market Turmoil: Causes and Consequences: Hearings Before the S. Committee on Banking, Housing, and Urban Affairs, 110th Cong. 7 (2007) (statement of Brendan McDonagh, CEO, HSBC Finance Corporation).
[18] 30 LPRA §2721.

realizar el valor del bien que garantiza la obligación. Al deudor constituir el fideicomiso, éste acuerda con el acreedor que, en caso de incumplimiento con su obligación, el fiduciario procederá a tasar la propiedad al valor del mercado y a venderla al mejor postor. Los ingresos de la venta serán aplicados a la extinción de la obligación. Dicha autoliquidación permite un proceso expedito, que la realización de la garantía equivalga al precio del mercado y una reducción en el impacto negativo al patrimonio del deudor, al igual que aumenta las probabilidades de que exista un sobrante como resultado de la venta.

B. Alternativa a la Prenda

El derecho real de prenda sirve la misma función que la hipoteca al garantizar el pago de una obligación con el valor de un bien. La diferencia principal con la hipoteca estriba en que el bien es uno mueble y debe ser entregado al acreedor o a un tercero de mutuo acuerdo hasta la extinción de la deuda.[19] La realización del valor de la prenda se puede llevar a cabo a través de la vía judicial o en una subasta pública frente a notario. Bajo la prenda también hay una prohibición de pacto comisorio.

El fideicomiso de garantía, sin embargo, ofrece una mejor alternativa por varias razones. Primeramente, se puede fideicomitir cualquier tipo de bien. Segundo, el acreedor no entra en posesión del bien en ningún momento. Asimismo, la definición de incumplimiento y el proceso de liquidación correspondiente ya están pactados de antemano entre las partes. A modo de ejemplo, bajo este supuesto un agricultor puede fideicomitir su tractor para conseguir un préstamo que le permita continuar sembrando su finca. En caso de incumplimiento, el fiduciario podría proceder a re-poseer el tractor y venderlo al mejor postor.

C. Alternativa a la línea de crédito

El fideicomiso de garantía se puede utilizar como una alternativa a las tradicionales líneas de crédito que engrasan la maquinaria del financiamiento mercantil. Una empresa, por ejemplo, puede fideicomitir un bien inmueble, un flujo de efectivo o cualquier otro bien, y garantizar sus obligaciones en proporción al valor del *corpus* del fideicomiso. De esta manera, una vez extinguida una obligación se puede proceder a garantizar otra y así sucesivamente. En teoría, este tipo de proceso se podría realizar a perpetuidad.

En México, por ejemplo, el proceso de entrar y salir de los acreedores está reglamentado mediante legislación y no conlleva mayores dificultades. No se requiere de un proceso de refinanciamiento como pudiera ocurrir con

[19] 31 LPRA 5021.

una hipoteca que garantizaba una obligación que se extingue y que se quiere reutilizar para garantizar otra obligación. En este sentido, el Artículo 397 de la Ley General de Títulos y Operaciones de Crédito establece:

> Cuando así se señale, un mismo fideicomiso podrá ser utilizado para garantizar simultánea o sucesivamente diferentes obligaciones que el fideicomitente contraiga, con un mismo o distintos acreedores, a cuyo efecto cada fideicomisario estará obligado a notificar a la institución fiduciaria que la obligación a su favor ha quedado extinguida, en cuyo caso quedarán sin efectos los derechos que respecto de él se derivan del fideicomiso. La notificación deberá entregarse mediante fedatario público a más tardar a los cinco días hábiles siguientes a la fecha en la que se reciba el pago.
>
> A partir del momento en que el fiduciario reciba la mencionada notificación, el fideicomitente podrá designar un nuevo fideicomisario o manifestar a la institución fiduciaria que se ha realizado el fin para el cual fue constituido el fideicomiso.
>
> El fideicomisario que no entregue oportunamente al fiduciario la notificación a que se refiere este artículo, resarcirá al fideicomitente los daños y perjuicios que con ello le ocasione.[20]

D. Alternativa a la Anticresis

La anticresis es un contrato real accesorio que, según definido en el Código Civil de Puerto Rico, le confiere al acreedor el derecho de percibir los frutos de un inmueble de su deudor, con la obligación de aplicarlos al pago de los intereses, si se debieren, y después al pago del capital del crédito mismo.[21] Una vez extinguida la obligación principal, el deudor recupera el goce del inmueble. En caso de incumplimiento, el acreedor anticresista tiene el derecho de exigir la venta del inmueble por la vía judicial o el pago de la deuda. De nuevo, el fideicomiso de garantía funcionaría de manera más eficiente al permitir la venta extrajudicial del bien inmobiliario.

E. Otras concepciones

La flexibilidad y la eficiencia permitida por el fideicomiso de garantía permite la creación de una infinidad de contratos para garantizar el pago de obligaciones de manera superior a las garantías tradicionales. Esta nueva

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[20] Ley General de Títulos y Operaciones de Crédito [L.G.T.O.C], según enmendada, Art. 397, Diario Oficial de la Federación, 27 de agosto de 1932 (Mex.).
[21] 31 LPRA 5061.

garantía, además, permite que los bienes fideicomitidos puedan ser de cualquier naturaleza siempre y cuando cumpla con la normativa jurídica. La autonomía de la voluntad y la ley son los límites absolutos del tipo de garantía que se pudiese configurar.

V. HACIA UNA NUEVA LEY DE FIDEICOMISOS Y LA INTRODUCCIÓN DEL FIDEICOMISO DE GARANTÍA

La eficiencia en la protección de los derechos de crédito ofrecida por el fideicomiso de garantía es el punto más importante en su función de alternativa a las garantías tradicionales. En Puerto Rico, sin embargo, el ordenamiento jurídico no ofrece una ley de fideicomisos que incluya dicha figura jurídica.

En las secciones restantes de este trabajo, ofreceremos una serie de recomendaciones que podrían servir como guía para la redacción de una nueva ley de fideicomisos que contenga una sección específica para el fideicomiso de garantía. También abordaremos algunos de los posibles conflictos teóricos y prácticos que pudiesen servir de obstáculos para la adopción de esta figura de tanto potencial para el tráfico jurídico en Puerto Rico.

VI. FUENTES DE REFERENCIA EN EL DERECHO COMPARADO

Nuestra búsqueda de fuentes de referencia de derecho comparado incluyó mayormente países de Latinoamérica y legislación a nivel estatal y federal en los Estados Unidos. A continuación desglosamos las fuentes de referencia a las que prestamos mayor importancia por tratarse de países que cuentan con la mayor reglamentación del fideicomiso de garantía o por contener disposiciones de especial interés en nuestra formulación de una propuesta.

> Puerto Rico: Como establecido anteriormente, el fideicomiso de garantía no existe en el ordenamiento jurídico puertorriqueño.
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> Argentina: Este es uno de los países civilistas que más ha desarrollado el fideicomiso mercantil a través de su Ley para el Financiamiento de la Vivienda y la Construcción del 9 de enero de 1995. Dicha ley define el fideicomiso de la siguiente manera: "Habrá fideicomiso cuando una persona (fiduciante) transmita la propiedad fiduciaria de bienes determinados a otra (fiduciario), quien se obliga a ejercerla en beneficio de quien se designe en el contrato (beneficiario), y a transmitirlo al cumplimiento de un plazo o condición al fiduciante, al beneficiario o al fideicomisario".[22] La ley

[22] Ley Núm. 24441, 9 de enero de 1995 [LV-A] ADLA 296 (Arg.).

> argentina no hace mención específica del fidecomiso de garantía en su texto. Nada impide, sin embargo, el que se aplique la figura del fideicomiso a la tarea de garantizar el cumplimiento de obligaciones.

> México: La Ley General de Títulos y Operaciones de Crédito de 1932, reconoce explícitamente a la figura del fideicomiso de garantía como una variante del fideicomiso y lo regula con una normativa muy específica.[23] Nos dice Alfredo Morles:

> > La ley establece que en el fideicomiso de garantía las partes podrán convenir la forma en que la institución fiduciaria procederá a enajenar extrajudicialmente, a título oneroso, los bienes o derechos en fideicomiso siempre que se hagan unos pactos mínimos, que incluyen la recepción de un aviso por parte del fiduciario acerca del incumplimiento antes del inicio del procedimiento; que se notifique por escrito al fideicomitente, quien sólo podrá oponerse a la enajenación si exhibe el importe del adeudo, acredita el cumplimiento de la obligación o presenta un documento de prórroga del plazo o de novación de la obligación. Si no ocurre ninguna de estas alternativas, se podrá proceder a la ejecución en los plazos señalados convencionalmente.[24]

En nuestra opinión, es la ley más completa que hemos encontrado en materia de fideicomiso de garantía. No obstante, cabe señalar que la misma sufrió cambios significativos tan recientemente como en el año 2003.

> Colombia: Los artículos principales que rigen el fideicomiso de garantía se encuentran en el Código de Comercio y disponen lo siguiente:

> > *Artículo 1226. Concepto de la fiducia mercantil*. La fiducia mercantil es un negocio jurídico en virtud del cual una persona, llamada fiduciante o fideicomitente, transfiere uno o más bienes especificados a otra, llamada fiduciario, quien se obliga a administrarlos o enajenarlos para cumplir

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[23] [L.G.T.O.C], *supra* nota 20 (Mex.).

[24] Alfredo Morles Hernández, El Fideicomiso de Garantía del Derecho Venezolano, discurso en el XVIII Congreso Latinoamericano de Fideicomiso (2008). *Véase* http://www.felaban.com/archivos/memorias_XVIII_congreso/pres_word_alfredo_morles.pdf (última visita 23 de abril de 2011).

> una finalidad determinada por el constituyente, en provecho de éste o de un tercero llamado beneficiario o fideicomisario. Una persona puede ser al mismo tiempo fiduciante y beneficiario.-Sólo los establecimientos de crédito y las sociedades fiduciarias, especialmente autorizados por la Superintendencia Bancaria, podrán tener la calidad de fiduciarios.[25]
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> *Artículo 1227. Obligaciones garantizadas con los bienes entregados en fideicomiso*. Los bienes objetos de la fiducia no forman parte de la garantía general de los acreedores del fiduciario y sólo garantizan las obligaciones contraídas en el cumplimiento de la finalidad perseguida.[26]

Perú: La Ley General del Sistema de Financiero y del Sistema de Seguros y Orgánica de la Superintendencia de Banca y Seguros de 1996 regula específicamente el fideicomiso de garantía.[27] Específicamente, en su artículo 274 ésta dispone que la empresa que otorgue créditos con una garantía fiduciaria constituida con una tercera empresa fiduciaria se resarcirá del crédito incumplido con el resultado que se obtenga de la ejecución del patrimonio fideicomitido, en la forma prevista en el contrato o con el propio patrimonio fideicomitido cuando éste se encuentre integrado por dinero, dando cuenta, en este último caso, a la superintendencia.[28] El artículo 274 también establece que son excluyentes la calidad de fiduciario y acreedor.[29] Por su parte, los artículos 15 y 16 de la Resolución Núm. 1010-99 del Superintendente de Banca y Seguros de 1999[30], refinaron la reglamentación del fideicomiso de garantía. En el primer artículo acerca de fideicomisos dice lo siguiente: "[l]a Superintendencia dicta normas generales sobre los diversos tipos de negocios fiduciarios"; por lo que tuvimos que remitirnos a la Resolución Núm. 1010-99 del Superintendente de Banca y Seguros.

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[25] Código de Comercio [C.Com] Art.1226. Decreto 410, marzo 27 de 1971, Diario Oficial Núm. 33.339 [D.O.], 16 de junio de 1971 (Colombia).
[26] C. Com Art. 1227 (Colombia).
[27] Ley Núm. 26702, Ley General del Sistema Financiero y del Sistema de Seguros y Orgánica de la Superintendencia de Banca y Seguros [L.G.S.F.S.O.S.B.S.], Diario Oficial El Peruano [D.O.], 9 de diciembre de 1996 (Perú).
[28] L.G.S.F.S.O.S.B.S. Art. 274 (Perú).
[29] *Id*.
[30] Resolución SBS Núm. 1010-99, Reglamento del Fideicomiso y de las Empresas de Servicios Fiduciarios, Diario Oficial El Peruano, pág. 180233, 13 de noviembre de 1999 (Perú).

Venezuela: El fideicomiso está definido expresamente en el Artículo 1 de Ley de Fideicomisos del 23 de julio de 1956[31] como "una relación jurídica por la cual una persona llamada fideicomitente transfiere uno o más bienes a otra persona llamada fiduciario, quien se obliga a utilizarlo en favor de aquél o de un tercero llamado beneficiario." El Artículo 6, además, establece que puede constituirse fideicomiso "sobre toda clase de bienes, salvo aquéllos que, conforme a la Ley, sean estrictamente personales de su titular".[32] El fideicomiso de garantía no está reconocido expresamente en la legislación venezolana.

Costa Rica: El fideicomiso de garantía se encuentra específicamente regulado por el Artículo 648 del Código de Comercio.[33] El Código de Comercio le permite a los bancos entrar en contrato de fideicomiso y establece que: "[p]uede constituirse un fideicomiso sobre bienes o derechos en garantía de una obligación del fideicomitente con el fideicomisario. En tal caso, el fiduciario puede proceder a la venta o remate de los bienes en caso de incumplimiento, todo de acuerdo con lo dispuesto en el contrato".[34]

Estados Unidos: En los Estados Unidos el fideicomiso es regulado a nivel estatal y a nivel federal. Frente a la diversidad de reglamentaciones existentes a través de los Estados, en el 2000 se aprobó el *Uniform Trust Code*, para proveer un articulado estándar pero modificable por cada Estado. El fideicomiso de garantía, sin embargo, no está reconocido expresamente. No obstante, sus aplicaciones se encuentran en por lo menos dos campos: como un sustituto de la hipoteca llamado *deed of trust*[35] que existe y es regulado a nivel estatal en veintidós (22) estados[36] y como

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[31] Ley de Fideicomisos [L.F.] del 23 de julio de 1956, Gaceta Oficial de la República de Venezuela Núm. 496 Extraordinario [G.O.], 17 de agosto de 1956 (Venezuela).
[32] *Id.,* Art. 6 (Venezuela).
[33] Ley Núm. 3284 de 24 de abril de 1964, Código de Comercio [C.Com], La Gaceta Núm. 119, 27 de mayo de 1964 (Costa Rica).
[34] C. Com. Art. 648 (Costa Rica). La Ley Núm. 7732 de 17 de diciembre de 1997, Ley Reguladora del Mercado de Valores[L.R.M.V.], Art. 187, La Gaceta Núm. 18, 27 de enero de 1998 (Costa Rica), añadió la oración citada como segundo párrafo al Art. 648 del Código de Comercio de 1964.
[35] Un "*deed of trust"* funciona de la siguiente manera: la propiedad es traspasada por el titular-deudor a un fiduciario (usualmente una compañía de títulos) quien la ejerce en beneficio de un beneficiario-acreedor que ha prestado una suma de dinero al titular-deudor. Una vez extinguida la obligación, el fiduciario le traspasa el título al titular de la propiedad. Si durante la vida de la obligación, el deudor incumple, el fiduciario tiene el poder de liquidar la propiedad para repagar el préstamo y, de haber sobrante, se lo entrega al deudor.
[36]Alaska, Arizona, Arkansas, California, Colorado, Distrito de Columbia, Idaho, Iowa, Maryland, Mississippi, Missouri, Nebraska, Nevada, Carolina del Norte, Oregon, Dakota del Sur, Tennessee, Texas, Utah, Virginia, Washington y Nuevo México.

protección a bonistas en forma de un *trust indenture*[37] *o un collateral trust bond.*[38] Estas últimas dos figuras son reguladas a nivel del Gobierno Federal por el Trust Indenture Act de 1939.[39]

Por otro lado, dentro de la misma jurisdicción estadounidense, examinamos la legislación relevante en los estados de:

Alaska: Capítulo 20 del Tomo 34 de las Leyes de Alaska. Disposiciones relativas a hipotecas y fideicomisos de garantía.[40]

Texas: Sección 51.006 del *Texas Property Code* – Interesante disposición que permite que un acreedor de una deuda respaldada por un fideicomiso de garantía pueda aceptar el traspaso de titularidad de la propiedad objeto del fideicomiso en pago de la deuda.[41]

Virginia: El Capítulo 4 del título 55 del Código de Virginia contiene extensa regulación de forma para las escrituras de propiedad inmueble. Nos pareció de especial importancia la sección 55-52, para el traspaso o cesión de propiedad de la que no se es dueño, pero que se adquiere posteriormente.[42]

Arizona: Capítulo 6.1 del Tomo 33 de las Leyes Revisadas de Arizona. Una de las legislaciones más completas y organizadas en materia de fideicomisos de garantía.[43]

Yap: Incorporamos a nuestras fuentes una ley del Estado de Yap, que forma parte de los Estados Federados de Micronesia en el Pacífico.[44]

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[37] A Trust Indenture is an agreement in a bond contract made between a bond issuer and a trustee that represents the bondholder's interests by highlighting the rules and responsibilities that each party must adhere to. One section of the trust indenture dictates the circumstances and processes surrounding a default. *Véase* http://www.investopedia.com/terms/t/trust_indenture.asp (última visita 23 de abril de 2011).

[38] A Collateral Trust Bond is a bond that is secured by a financial asset - such as stock or other bonds - that is deposited and held by a trustee for the holders of the bond. If the issuing company were to default on the debt obligation, the debt holders would receive the securities held in trust, like collateral for a loan. *Véase* http://www.investopedia.com/terms/c/collateraltrustbond.asp (última visita 23 de abril de 2011).

[39] 15 U.S.C. §§ 77aaa-77bbbb.

[40] Alaska Stat. §§ 34.20.010-34.20.160 (1988).

[41] Tex. Prop. Code Ann. § 51.006 (1995).

[42] Va. Code Ann. §55-52.

[43] Ariz. Rev. Stat. Ann. §§ 33-801-33-821 (1971).

VII. DELIMITACIÓN DEL ALCANCE DE NUESTRO TRABAJO

Nuestro trabajo consistió en enfocar en el tema del fideicomiso de garantía con la finalidad de redactar legislación para su incorporación al ordenamiento jurídico de Puerto Rico. Presentamos una serie de artículos para regular expresamente el fideicomiso de garantía, que serían unidos a un cuerpo más amplio que regule el fideicomiso mercantil. Por razones de espacio y por ser un borrador de referencia, no incluiremos los artículos redactados. Bastará para este artículo una discusión de los puntos más sobresalientes en nuestro análisis.

VIII. DISCUSIÓN DE LOS PUNTOS MÁS IMPORTANTES DE NUESTRA PROPUESTA

A. Definición del fideicomiso de garantía

Lisoprawski y Kiper definen el fideicomiso de garantía como:

> [E]l contrato mediante el cual el fiduciante transfiere la propiedad (fiduciaria) de uno o más bienes a un fiduciario con la finalidad de garantizar con ellos, o con su producido, el cumplimiento de ciertas obligaciones a cargo de aquél o un tercero, designando como beneficiario al acreedor o a un tercero, en cuyo favor, en caso de incumplimiento, se pagará la obligación garantizada, según lo previsto en la convención fiduciaria.[45]

Por su parte, el Banco de Inversión y Comercio Exterior de Argentina define el fideicomiso de garantía de la siguiente forma:

> El fideicomiso de garantía es aquel por el cual una persona (fiduciante) transfiere la propiedad fiduciaria a otra (fiduciario) para garantizar una deuda que la primera tiene con la segunda o con un tercero. *En caso de incumplimiento, el fiduciario procede a vender el bien y con lo recaudado cobra su crédito o del tercero y el remanente del precio se lo entrega al deudor.*[46]

Asimismo, según la Resolución 1010-99 del Superintendente de Banca y Seguros de Perú:

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[44] Yap State Law 3-64, Deed of Trust Act of 1987. Yap State Code tit. 29, §§2-201 a 2-225.
[45] KIPER & LOSOPRAWSKI, *supra* nota 5.
[46] http://www.bice.com.ar/SP/contenidos/contenidos.asp?id=91 (última visita 23 de abril de 2011). Enfasis suplido.

> En el fideicomiso en garantía los bienes integrados en el patrimonio fideicomitido están destinados a asegurar el cumplimiento de determinadas obligaciones, *concertadas o por concertarse*, a cargo del fideicomitente *o de un tercero*. El fideicomisario, en su calidad de acreedor puede requerir al fiduciario la ejecución o enajenación de acuerdo al procedimiento establecido en el acto constitutivo.[47]

Proponemos que se tome como punto de partida la primera definición presentada y se incorporen los puntos a los que hicimos énfasis en las restantes dos. De este modo se ilustra el proceso transaccional, incluyendo las figuras que lo componen. También introduce como obligaciones las concertadas o por concertarse. Por último, para crear mayor dinamismo a nuestra figura del fideicomiso de garantía, sugerimos incluir expresamente la posibilidad de que se pueda utilizar un mismo fideicomiso como garantía simultánea o sucesiva en diferentes obligaciones con uno o con distintos acreedores, según ocurre en México.[48]

B. Separación de bienes fideicomitidos

Según el Artículo 1233 del Código de Comercio de Colombia "[p]ara todos los efectos legales, los bienes fideicomitidos deberán mantenerse separados del resto del activo del fiduciario y de los que correspondan a otros negocios fiduciarios, y forman un patrimonio autónomo afecto a la finalidad contemplada en el acto constitutivo".[49] Asimismo, en el Artículo 1238 de dicho Código de Comercio se establece que: "[l]os bienes objeto del negocio fiduciario no podrán ser perseguidos por los acreedores del fiduciante, a menos que sus acreencias sean anteriores a la constitución del

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[47] Resolución SBS Núm. 1010-99, *supra* nota 30 (Perú). Énfasis suplido.

[48] L.G.T.O.C. Art. 397, *supra* nota 20 (Mex.):

> Cuando así se señale, un mismo fideicomiso podrá ser utilizado para garantizar simultánea o sucesivamente diferentes obligaciones que el fideicomitente contraiga, con un mismo o distintos acreedores, a cuyo efecto cada fideicomisario estará obligado a notificar a la institución fiduciaria que la obligación a su favor ha quedado extinguida, en cuyo caso quedarán sin efectos los derechos que respecto de él se derivan del fideicomiso. La notificación deberá entregarse mediante fedatario público a más tardar a los cinco días hábiles siguientes a la fecha en la que se reciba el pago.
>
> A partir del momento en que el fiduciario reciba la mencionada notificación, el fideicomitente podrá designar un nuevo fideicomisario o manifestar a la institución fiduciaria que se ha realizado el fin para el cual fue constituido el fideicomiso.
>
> El fideicomisario que no entregue oportunamente al fiduciario la notificación a que se refiere este artículo, resarcirá al fideicomitente los daños y perjuicios que con ello le ocasione.

[49] C.Com Art. 1233, *supra* nota 25 (Colombia).

mismo. Los acreedores del beneficiario solamente podrán perseguir los rendimientos que le reporten dichos bienes".[50]

Estas disposiciones quedaron mejor recogidas en la legislación Argentina, de la cual dimanan los incisos de nuestra propuesta en referencia al tema de la separación de bienes fideicomitidos. Estas disposiciones colocan los bienes fideicomitidos en una esfera individual, creando un patrimonio autónomo libre de las acreencias del fideicomitente, fiduciario o fideicomisario. De este modo, surgirá en nuestra jurisdicción una declaración expresa de patrimonio separado del fideicomiso, a diferencia de la ley venezolana, en la que no existe tal declaración y ha tenido que ser suplida mediante la aproximación de la doctrina jurisprudencial.

C. Definición de Dominio Fiduciario

En Perú, la Resolución Núm. 1010-99 del Superintendente de Banca y Seguros define el dominio fiduciario como:

> [E]l derecho de carácter temporal que otorga al fiduciario las facultades necesarias sobre el patrimonio fideicomitido, para el cumplimiento del fin o fines del fideicomiso, con las limitaciones establecidas en el acto constitutivo**...** El dominio fiduciario se ejerce desde la transferencia de los bienes objeto del fideicomiso, salvo disposición contraria establecida en el acto constitutivo, hasta el término del fideicomiso.[51]

En Colombia, por su parte, el Artículo 1244 del Código de Comercio establece que "[s]erá ineficaz toda estipulación que disponga que el fiduciario adquirirá definitivamente, por causa del negocio fiduciario, el dominio de los bienes fideicomitidos".[52]

Recae en la figura del fiduciario ser el ejecutor de la garantía según lo disponga el fideicomitente en el acto constitutivo del fideicomiso. Éste podrá, incluso, tener las facultades para diseñar la garantía o porción de la garantía que será ejecutada a los fines de disolver la acreencia del deudor. También es posible que el fideicomitente le confiera la facultad al fiduciario para que éste asuma obligaciones sobre los bienes que integran el patrimonio fideicomitido. Alfredo Morales apunta hacia un posible cuestionamiento de la capacidad del fiduciario de constituir la garantía, al no poseer el dominio absoluto del bien. En jurisdicciones como la de Venezuela, por ejemplo, donde no ha sido definido legislativamente el concepto de dominio fiduciario, se "sobreentiende que se ha transferido un dominio fiduciario que se puede

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[50] C. COM. 1238, *supra* nota 25 (Colombia).
[51] Resolución SBS Núm. 1010-99, *supra* nota 30 (Perú).
[52] C. COM. 1244, *supra* nota 25 (Colombia).

transformar en dominio absoluto, por la naturaleza propia del contrato de garantía".[53] En nuestra jurisdicción no tendría que ser conjeturada dicha capacidad, al poder aparecer definida legislativamente como en las jurisdicciones de Perú, Colombia y Argentina.

D. Fiduciario y beneficiario en una misma institución

Existen muchos países en Latinoamérica donde la superposición de las figuras de fiduciario y fideicomisario en una misma persona está expresamente prohibida. En otros países, como México y Brasil, se admite esta superposición. Otros países permiten la incorporación de ambas figuras sólo en los supuestos en que exista más de un fiduciario o beneficiario. El derecho mexicano ha reconocido instancias en las que se permite que ambas figuras recaigan en una misma institución:

> L.G.T.O.C. Art. 382: La institución fiduciaria podrá ser fideicomisaria en los fideicomisos que tengan por fin servir como instrumentos de pago de obligaciones incumplidas, en el caso de créditos otorgados por la propia institución para la realización de actividades empresariales. En este supuesto, las partes deberán convenir los términos y condiciones para dirimir posibles conflictos de intereses.[54]

> L.G.T.O.C. Art. 396: Las instituciones y sociedades mencionadas en el artículo anterior, podrán reunir la calidad de fiduciarias y fideicomisarias, tratándose de fideicomisos cuyo fin sea garantizar obligaciones a su favor. En este supuesto, las partes deberán convenir los términos y condiciones para dirimir posibles conflictos de intereses.[55]

En los Estados Unidos, el *Uniform Trust Code* establece que el fideicomiso se considerará constituido toda vez que la misma persona no sea el único fiduciario y el único beneficiario.[56] Con ello se permite la superposición cuando existe más de un fiduciario y beneficiario. En una revisión hecha en el año 2005, por el *National Conference of Commissioners on Uniform State Laws*, se omitió esta sección. En los comentarios a dicho cambio se expresó que esto surgió debido a que encontraron que algunos tribunales estaban haciendo una aplicación inapropiada del estatuto que invalidaba declaraciones unilaterales en las que el fideicomitente es el

[53] Morales Hernández, *supra* nota 24.
[54] L.G.T.O.C. Art. 382, supra nota 20 (Mex.).
[55] L.G.T.O.C. Art. 396, *supra* nota 20 (Mex.).
[56] U.T.C. § 402 (a)(5) (2000).

beneficiario durante su vida, pero otra persona es designada como beneficiario durante el período de duración remanente establecido en el fideicomiso. Según se desprende de lo discutido en la antedicha conferencia, esta doctrina es aplicable solamente si todos los beneficios son asignados a la misma persona, sea este el fideicomitente u otra persona.[57]

En Puerto Rico, nuestra legislación confiere la facultad a los bancos y a las Compañías de Fideicomisos para actuar como fiduciarios.[58] El Artículo 302 de la Ley de Compañías de Fideicomisos define a estas compañías como "una corporación del país formada con el objeto de tomar, aceptar y cumplir o ejecutar los fideicomisos que legalmente se le confíen, actuando, como fiduciaria en los casos prescritos por la ley".[59] Asimismo, la Ley de Bancos confiere a los bancos la facultad de "[t]omar, aceptar y cumplir o ejecutar toda clase de fideicomisos que legalmente se le confíen, actuando como fiduciario (*trustee*) en todos los casos prescritos por la Ley".[60]

Creemos necesario que exista en nuestra jurisdicción una regulación específica sobre la superposición de las figuras de fiduciario y fideicomisario en el fideicomiso de garantía. Nos inclinamos a que se permita esta superposición en el caso de entidades financieras autorizadas por el Comisionado de Instituciones Financieras, quien estará a cargo de regular esta materia mediante la facultad de crear reglamentos al respecto. Esto tendría el beneficio de agilizar la adaptación de la regulación a los cambios que surjan en el mundo de los negocios, además de delegar esta función a una agencia con mayor peritaje en el tema. También ayudaría a evitar el supuesto en que un acreedor, que no esté reglamentado como institución financiera, se dedique al lucro mediante ejecuciones, lo que claramente conlleva un conflicto de intereses.

Como hemos aclarado anteriormente, uno de los propósitos del mecanismo de fideicomiso de garantía para el consumidor es disminuir las tasas de intereses en sus deudas. Las instituciones financieras se benefician de un menor riesgo de incobrabilidad, lo que resulta en ahorros para el deudor. Dichas instituciones tampoco basan su lucro en la ejecución de garantías, sino en la ganancia mediante la diferencia en tasas de interés. El fideicomitente también contaría con acciones resarcitorias si estos fiduciarios incumplen con lo dispuesto en el contrato. Adicionalmente, el Comisionado de Instituciones Financieras ejercería una labor supervisora

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[57] "The doctrine of merger is properly applicable only if all beneficial interests, both life interests and remainders are vested in the same person, whether in the settlor or someone else. An example of a trust to which the doctrine of merger would apply is a trust of which the settlor is sole trustee, sole beneficiary for life, and with the remainder payable to the settlor's probate estate." *Id.* a la § 402.

[58] Ley de Compañías de Fideicomisos, Ley Núm. 40 de 23 de abril de 1928, 7 LPRA §§ 301-503. Ley de Bancos de Puerto Rico, Ley Núm. 55 de 12 de mayo de 1933, 7 LPRA §§ 1-278.

[59] 7 LPRA § 302 .

[60] 7 LPRA § 111.

sobre las prácticas de estas instituciones, por lo que se cuentan con mecanismos de protección suficientes para permitir la superposición de las figuras de fiduciario y beneficiario en las instituciones que cualifiquen.

El riesgo de que exista un conflicto de intereses queda opacado en el caso del fideicomiso de garantía debido a que las facultades del fiduciario quedan limitadas a lo que disponga el fideicomitente en las cláusulas del contrato. Es decir, quien designa al fiduciario es el acreedor y éste tiene la potestad de definir cómo deberá actuar el fiduciario. Nuestra propuesta, además, impone, en el fiduciario, la responsabilidad de rendir cuentas al fideicomitente, pudiendo este último establecer en el contrato el modo en el que se llevará a cabo esta rendición de cuentas.

D. Regulación de empresas que actúen como fiduciarios

De nuestra búsqueda surge que la mayoría de los países consultados delega la regulación de las empresas que actúen como fiduciarias a agencias análogas a nuestro Comisionado de Instituciones Financieras.[61] En Puerto Rico contamos con la Ley de Bancos, que, como explicamos anteriormente, permite a los bancos fungir como fiduciarios. Al mismo tiempo, la mencionada ley faculta al Comisionado de Instituciones Financieras para ser el ente fiscalizador de estas instituciones. En nuestra legislación también contamos con la Ley de Compañías de Fideicomisos, que delega en el Secretario de Hacienda la facultad de autorizar y reglamentar la actividad de compañías de fideicomisos que no sean bancos. [62] Nuestra propuesta hace referencia expresa a estas dos leyes para la regulación de las empresas que actúen como fiduciarias, lo que sustenta la permisión expresa a la

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[61] Resolución SBS 1010-99 (Perú): Las empresas de operaciones múltiples a que se refiere el inciso A del artículo 16 de la Ley General, las empresas de servicios fiduciarios, las empresas de seguros, las empresas de reaseguros y la Corporación Financiera de Desarrollo S.A. (COFIDE), pueden desempeñarse como fiduciarios de acuerdo con lo dispuesto en el artículo 242 de la Ley General. Ver Resolución SBS Núm. 1010-99, *supra* nota 30.

Código de Comercio Art. 1226 (Colombia): Solo los establecimientos de crédito y las sociedades fiduciarias, especialmente autorizados por la Superintendencia Bancaria, podrán tener la calidad de fiduciarios. Ver C. Com Art. 1226, *supra* nota 25 (Colombia).

L.G.T.O.C. Artículo 395 (México)**:** Sólo podrán actuar como fiduciarias de los fideicomisos que tengan como fin garantizar al fideicomisario el cumplimiento de una obligación y su preferencia en el pago, previstos en esta Sección Segunda, las instituciones y sociedades siguientes: Instituciones de crédito; Instituciones de seguros; Instituciones de fianzas; Casas de bolsa; Sociedades financieras de objeto múltiple a que se refiere el artículo 87-B de la Ley General de Organizaciones y Actividades Auxiliares del Crédito; Almacenes generales de depósito, y Uniones de crédito. Ver L.G.T.O.C. Art. 395, *supra* nota 20 (Mex.).

[62] 7 LPRA § 301.

superposición de la figura del fiduciario y beneficiario que proponemos en el caso de compañías de fideicomisos e instituciones financieras.

E. Aspectos contractuales

Nuestra propuesta toma prestada la mayoría de los requisitos contractuales de la Resolución Núm. 1010-99 del Superintendente de Banca y Seguros de Perú[63] y del Artículo 399 de la Ley General de Títulos y Operaciones de Crédito de México.[64] Estos incluyen como mínimo, aspectos indispensables para la constitución del fideicomiso de garantía, como por ejemplo: (i) identificación de los bienes que formarán parte del patrimonio fideicomitido; (ii) determinación de las obligaciones que serán garantizadas con el patrimonio fideicomitido (aclarando que existe la opción de utilizar un mismo fideicomiso como garantía simultánea o sucesiva en diferentes obligaciones con uno o con distintos acreedores); (iii) el procedimiento que se aplicará en la enajenación de los bienes que integran el patrimonio fideicomitido de ocurrir el incumplimiento de las obligaciones; (iv) el monto de dicho patrimonio que estará destinado para garantizar el cumplimiento de obligaciones; (v) la forma en que se valorará el patrimonio fideicomitido previo a su enajenación; y (vi) el criterio a utilizarse para la selección de los bienes a ser enajenados para cumplir con la obligación en caso de patrimonios con múltiples bienes.

F. Términos en los que se revisará el contrato en caso de aumento de valor del patrimonio fideicomitido

Por otro lado, proponemos que se permita que las partes puedan pactar los términos en los cuales se revisará el contrato en caso que el patrimonio fideicomitido aumente de valor. En este supuesto, las partes podrán pactar para una disminución del porcentaje o monto del patrimonio fideicomitido que estará destinado para respaldar el cumplimiento de las obligaciones. Esta facultad puede dar lugar a que el desplazamiento del monto del patrimonio que estará destinado para respaldar la obligación permita que se puedan garantizar otras obligaciones sucesivas.

G. Solemnidades

Proponemos, asimismo, que sea requisito que el contrato que da lugar a un fideicomiso de garantía sea por escrito. En los casos de patrimonios que incluyan propiedades inmuebles, será requisito que el negocio conste en escritura pública; en el caso de patrimonios con bienes muebles, bastará con

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[63] Resolución SBS Núm. 1010-99, *supra* nota 30 (Perú).
[64] L.G.T.O.C. Art. 399, *supra* nota 20 (Mex.).

un documento privado. El incumplimiento con las formalidades mínimas antes descritas dará lugar a la nulidad del fideicomiso de garantía.

H. Constitución de fideicomiso con propiedad que no ha sido adquirida por el fiduciante

Como mencionáramos anteriormente, el Capítulo 4 del título 55 del Código de Virginia contiene extensa regulación de forma para las escrituras de propiedad inmueble.[65] De especial importancia nos pareció la sección 55-52, para el traspaso o cesión de propiedad de la que no se es dueño, pero que se adquiere posteriormente.[66] Basados en dicha disposición proponemos un artículo que leería como sigue:

> Cuando el fideicomiso sea constituido mediante escritura pública y se describa en los bienes que formarán parte del patrimonio fideicomitido un bien mueble o inmueble, con certeza razonable, de cuyo bien el fideicomitente no sea dueño al momento de constitución del fideicomiso, pero que posteriormente adquiera; dicho fideicomiso surtirá efecto como si el fideicomitente hubiera sido dueño del bien al momento de que se otorgara la escritura pública.

Con este artículo pretendemos facilitar la creación de fideicomisos de garantías en situaciones en las que, por ejemplo, el bien que se pretende comprar será financiado mediante una obligación a ser garantizada con la propiedad que se compre.

I. Protección frente a terceros

Según se desprende de nuestra investigación, no existe un deber jurídico de inscribir los fideicomisos de bienes inmuebles en el Registro de la Propiedad en ninguna de las jurisdicciones estudiadas. En nuestra propuesta tampoco quisimos que el acto de inscripción fuera constitutivo en el caso del fideicomiso de garantía con bienes inmuebles, como es el caso con el derecho de hipoteca. No obstante, el principio de fe pública registral permite que el titular de un derecho real pueda gozar de protección frente al tercero registral si inscribe su derecho. La publicidad registral le otorgaría legitimación registral al fideicomiso de garantía y protegería de terceros

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[65] Va Code Ann. §55-52 (1958).

[66] *Id*. Conveyance of property not owned but subsequently acquired. - When a deed purports to convey property, real or personal, describing it with reasonable certainty, which the grantor does not own at the time of the execution of the deed, but subsequently acquires, such deed shall, as between the parties thereto, have the same effect as if the title which the grantor subsequently acquires were vested in him at the time of the execution of such deed and thereby conveyed.

registrales que de buena fe adquieran la propiedad fideicomitida. Estos últimos prevalecerían sobre el acreedor de la deuda garantizada por el fideicomiso si adquieren la propiedad de buena fe y el fideicomiso no aparece inscrito en los asientos del Registro.

En el caso de los fideicomisos de garantía con patrimonio compuesto por bienes muebles, sugerimos la creación de un Registro de Fideicomisos de Garantía con Bienes Muebles para crear protección frente a terceros. Al igual que en el caso del fideicomiso inscribible en el Registro de la Propiedad, no existiría un deber jurídico de inscribir los fideicomisos de bienes inmuebles, ni su inscripción sería constitutiva. Las protecciones en el propuesto Registro de Fideicomisos de Garantía con Bienes Muebles operarían de igual modo que opera el principio de fe pública registral y protección del tercero registral en el Registro de la Propiedad. En Puerto Rico el Registro Mercantil es bastante parecido al registro de fideicomisos que proponemos. Este Registro ha caído en desuso y prácticamente está inoperante en nuestra jurisdicción. No obstante, no vemos por qué no pueda crearse este Registro de Fideicomisos de Garantía con Bienes Muebles de forma eficiente, efectiva y a bajo costo con las herramientas que contamos hoy para la digitalización de los registros.

J. Otras consideraciones y posibles controversias de derecho

La figura del fideicomiso no ha sido inmune a la controversia entre los juristas. En la literatura se encuentran numerosos debates que en la mayoría de los casos han sido superados, pero que vale la pena explorar. Entre los más importantes se encuentran:

K. La prohibición del pacto comisorio y el fideicomiso

Como hemos explicado anteriormente, los bienes fideicomitidos existen en un patrimonio paralelo al del fiduciario. Por lo tanto, bajo un supuesto de incumplimiento, el acreedor no puede apropiarse del bien. Sin embargo, algunos juristas se han opuesto a la implementación del fideicomiso de garantía basándose erróneamente en que la figura autoriza los pactos comisorios.

El caso de Colombia es ilustrativo de este debate que finalmente se resolvió a favor del fideicomiso de garantía en los años ochenta. En Colombia, el fideicomiso de garantía fue considerado como ilícito por la Superintendencia Bancaria. Sus argumentos giraron en torno a que la ejecución iba contra del derecho de defensa del deudor y que estaba en contra de la prohibición de pacto comisorio.[67] Estas objeciones fueron

[67] SERGIO RODRÍGUEZ AZUERO, NEGOCIOS FIDUCIARIOS, SU SIGNIFICACIÓN EN AMÉRICA LATINA 464-69, (1era ed., Legis, Bogotá 2005).

rechazadas por la doctrina colombiana, ya que la ejecución de los bienes fideicomitidos proviene y se hace acorde a las instrucciones dadas por el deudor/fideicomitente expresamente en el contrato. Éste realiza una decisión informada sobre su patrimonio, la cual es vinculante, sin dar cabida al tema de defensa.[68]

Ante el argumento de que el problema radicaba en que el bien del deudor se sacaba a remate, como lo haría un juez y sin audiencia del demandado, se respondió que el argumento es un sofisma porque el fiduciario no es, ni puede fungir, como juez para calificar el incumplimiento de una obligación y proceder por ende a ordenar la venta del bien en pública subasta; si así actúa el fiduciario es porque el mismo deudor lo ha instruido irrevocablemente. Con respecto al alegato de pacto comisorio, la doctrina observó que es el deudor quien ha dado instrucciones al fiduciario de entregar el bien al acreedor.[69] Finalmente, en 1981, "las objeciones que hacía la Superintendencia Bancaria colombiana fueron retiradas y… la legitimidad del fideicomiso de garantía fue incorporado a normas específicas".[70]

L. Transmisión de pleno dominio a través de un dominio imperfecto

Uno de los postulados del derecho es que no se puede transmitir un derecho que uno no posee. Bajo el fideicomiso de garantía, sin embargo este postulado parece encontrar una excepción. Como es sabido, a través de un contrato de fideicomiso, un fiduciario recibe un bien con un propósito específico: retener su título hasta la extinción de una obligación pecuniaria y le habilita para llevar a cabo acciones en protección de la propiedad. Su dominio, sin embargo, es uno de carácter limitado y denominado dominio fiduciario. Este tipo de dominio le prohíbe usar la propiedad, ingresarla a su patrimonio o enajenarla sin primero cumplir con los requisitos del contrato de fideicomiso. En el caso una realización del valor de los bienes fideicomitidos, el fiduciario tiene la capacidad de transmitir un pleno dominio a un nuevo titular.

M. Nulidad por lesión (desproporción de las contraprestaciones)

Este tema proviene de una antigua doctrina[71] diseñada para proteger al deudor frente a acreedores poderosos e inescrupulosos que pudiesen

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[68] *Id.,* en las págs. 468-69.
[69] *Id*., en las págs. 468-72.
[70] *Id*., en las págs. 472-75.
[71] En la doctrina del derecho comparado, la figura de la lesión ha surgido de un proceso secular de decantamiento que logró atemperar su significado y sus alcances. Desde hace 1500 años, el *Corpus Iuris Civilis* preveía absolutamente como natural la existencia de cierto lucro al contratar: "[...] al comprar y vender se admite como natural el comprar en menos lo que vale más, o vender en más lo que vale menos, y aprovecharse así de la otra parte (*Dig.*

aprovecharse del diferencial de poder en la negociación de un contrato para abusar del patrimonio del mismo. Dicha prohibición ha evolucionado a través de los años y se ha ido atemperando y, en algunas jurisdicciones, hasta eliminado del todo. Cualquier lesión se maneja caso a caso en los tribunales y se evalúa bajo los principios generales de los contratos y la equidad. En Argentina, sin embargo, la protección al deudor fue encapsulada en su Artículo 954 del Código Civil el cual lee:

> También podrá demandarse la nulidad o la modificación de los actos jurídicos cuando una de las partes explotando la necesidad, ligereza o inexperiencia de la otra, obtuviera por medio de ellos una ventaja evidentemente desproporcionada y sin justificación. Se presume, salvo prueba en contrario, que existe tal explotación en caso de notable desproporción en las prestaciones.[72]

Algunos juristas, entre ellos Leopoldo Peralta Mariscal, sostienen que el negocio jurídico que representa el fideicomiso de garantía es uno "ilícito" desde el principio por adolecer del vicio de lesión prohibido por el Art. 954.[73] De otro ángulo, nos dice Rodríguez-Azuero:

> Esta modalidad del fideicomiso mereció en sus orígenes algunos reparos por estimarse que se convertía en un mecanismo para que el acreedor se apoderara del bien recibido en garantía; se colocara al fiduciario en trance de ejercitar funciones jurisdiccionales y, por último, se privara al deudor del ejercicio legítimo del derecho de defensa. Sin embargo, . . . la figura se acepta hoy de manera pacífica con argumentos que, en términos generales, serían aplicables en otras latitudes, porque se ha hecho notar que no es una situación de controversia la que debe ser juzgada por el fiduciario, sino la simple circunstancia de hecho de que, en una cierta fecha, no se haya producido un pago. No hay pues en la gestión que debe cumplir el fiduciario ningún campo para la calificación subjetiva sobre la conducta de las partes sino simple y llanamente, sobre la circunstancia de no haberse realizado el pago. Pero, además, no se

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19.2.22)". Imaginando las dificultades y los abusos a que esto podía dar lugar, se regulaba la figura de la *laesio enormis* (es decir, un daño excesivo que superaba más de dos veces el precio real del objeto: *Cod*. 4.44.2, 4.44.8). José Antonio Márquez González, *Los principios generales de los contratos*, Letras Jurídicas, julio a diciembre 2004. *Véase* http://www.letrasjuridicas.com/Volumen10.html (última visita 23 de abril de 2011).

[72] Código Civil [Cód. Civ.] Art. 954 (Arg.).

[73] L. PERALTA MARISCAL, ANÁLISIS ECONÓMICO DEL FIDEICOMISO DE GARANTÍA. NUEVAS REFLEXIONES SOBRE SU ILICITUD, La Ley 2001-E, 1025. *Véase* http://www.quiebras-concursos.com.ar/?q=node/3 (última visita 23 de abril de 2011).

> trata de que el acreedor disponga por sí y ante si [sic] del bien recibido en garantía sino que tal bien ha sido transferido previamente por parte del deudor al fiduciario, en forma deliberada y consciente, encomendándole una determinada gestión que puede traducirse, seguramente, en la venta del bien y en el pago al acreedor, pero incluso, al cumplimiento de otras finalidades, si la suma lo permite. Y por último, no parece que haya propiamente una privación del derecho de defensa si se advierte que la renuncia anticipada a controvertir cualquier circunstancia accesoria tiene un contenido eminentemente patrimonial y dispositivo, como el que estaría implícito en un acuerdo transaccional que tal cosa previere.[74]

Innegablemente existe la posibilidad de abuso de parte de las personas. No por esto se puede detener el desarrollo de una figura jurídica. De igual manera se puede violentar la buena fe bajo cualquier garantía y existen remedios judiciales. En todo caso, los argumentos presentados por Peralta Mariscal sirven de advertencia para las entidades que regularán a los fiduciarios en Puerto Rico.

N. Estándar de diligencia con el cual se debe medir al fiduciario de un fideicomiso de garantía

El ordenamiento jurídico de Puerto Rico provee como estándar de diligencia al buen padre de familia al establecer que "[e]l obligado a dar alguna cosa lo está también a conservarla con la diligencia propia de un buen padre de familia".[75] El Tribunal Supremo de Puerto Rico al interpretar esta figura en *American Sec. Ins. Co. v. Ocasio*, la ha coloreado a grandes trazos estableciendo que el nivel de diligencia esperada variará caso a caso pero que dicho nivel "deber[á] ser [el] que hubiera tomado una persona tipo medio o normal diligente…".[76]

La figura del fiduciario, sin embargo, exige un estándar más alto que el del buen padre de familia. Esto, por ser una figura que será llevada a la vida por individuos técnicamente especializados que se desenvolverán en transacciones financieras sofisticadas. El no exigir este estándar más alto tendría el efecto de negarle al fiduciante-deudor y al beneficiario-acreedor de una herramienta que les permite exigirle a su fiduciario un grado de diligencia adecuada para la tarea que se le contrató. En fin, sería darle una carta blanca para llevar a cabo transacciones negligentes sin un verdadero riesgo de tener que responder por sus actuaciones.

En otras jurisdicciones latinoamericanas, como Uruguay, existe un estándar que pudiera suplir la ausencia de una figura más apropiada para los

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[74] Sergio Rodríguez-Azuero, *El fideicomiso mercantil contemporáneo*, 70 ICADE: Revista de las Facultades de Derecho y Ciencias Económicas y Empresariales 7-55 (2007).
[75] 31 LPRA § 3011.
[76] *American Sec. Ins. Co. v. Ocasio*, 102 DPR 166 (1974).

fideicomisos de garantía. Se denomina el buen hombre de negocios. Esta figura, presente en la Ley 16.060 de Sociedades Comerciales de Uruguay[77], exige un cierto trasfondo profesional al hombre de negocios ya que el estándar de diligencia y lealtad contra el cual se comparará su desenvolvimiento dependerá de la naturaleza del negocio en que se desempeñe. Para una apreciación correcta de la figura será esencial el correcto entendimiento de las funciones de un fiduciario dentro de su particular industria. Así, por ejemplo, al administrador de un fondo mutuo no se le podrá evaluar con la misma vara con la que se evalúa al fiduciario de un fideicomiso de garantía que reemplaza una hipoteca.

Es nuestro entendimiento que se debería importar e implementar esta figura ya existente en otros países civilistas como parte de una nueva ley de fideicomisos.

IX. CONCLUSIÓN

El comercio es la fuerza motriz de una economía. Por ende, aumentar la eficiencia transaccional del tráfico jurídico-comercial debe ser el norte de un gobierno de vanguardia. Al fin y al cabo, lo que se busca es que el capital fluya libremente por la economía y genere crecimiento económico y, consecuentemente, una reducción de la dependencia en el sistema de beneficencia gubernamental. Esta visión hace natural la incorporación del fideicomiso de garantía, una figura con una larga historia fuera de nuestra jurisdicción, al grupo de herramientas disponibles para los acreedores a la hora de asegurar el pago de sus créditos.

El fideicomiso de garantía, gracias a su diseño, promete reducir significativamente los costos asociados a la realización de las garantías en comparación con las garantías tradicionales reconocidas por el ordenamiento jurídico puertorriqueño. Esto, a su vez, se traduciría en un aumento en el capital disponible a los acreedores para ofrecer préstamos y en una reducción en los costos de financiamiento a los consumidores. Gracias a su diseño, también, se reduciría importantemente el número de pleitos relacionados a ejecuciones de hipoteca, prenda y otras garantías tradicionales. En fin, ganan tanto los acreedores como los propios deudores y el gobierno.

La amplia experiencia de otras jurisdicciones con esta figura deber servir de aliciente para su implementación en Puerto Rico. Nuestra propuesta para la introducción y reglamentación del fideicomiso de garantía ha examinado la normativa positiva y la crítica de un importante número de jurisdicciones, tanto de tradición civilista como del derecho común, con el fin

[77] Ley Núm. 16.060 de 1 de noviembre de 1989, Sociedades Comerciales, Diario Oficial Núm. 22977 [D.O.], 1 de noviembre 1989 (Uruguay).

de proponer un articulado de ley que le dé vida a la figura de la manera más eficiente, coherente y completa posible. Nuestra propuesta pretende también servir de guía para todo tipo de usuario de la ley con la intención que el fideicomiso de garantía se convierta en una parte integral de la economía de la manera más eficiente posible.

Con un poco de suerte y mucho trabajo, esperamos escuchar, en un futuro cercano, las primeras pautas publicitarias anunciando ofertas de fideicomisos de garantía a tasas por debajo de los intereses prestatarios prevalecientes al presente.

PUERTO RICO ACT 154: THE BEGINNING OF THE END? EFFECTS OF ACT 154 ON FUTURE ECONOMIC DEVELOPMENT

ARTICLE

FELIPE RODRÍGUEZ LAFONTAINE*

> *I am pleased to announce our plan to fulfill the promise that we made you of a tax reform that leaves you with More Money in Your Pockets . . . that gives a real tax relief to all and every single Puerto Rican . . . that rewards our workers . . . and stimulates savings and job creation.*
>
> *The tax reform that will be presented . . . is, without a doubt, the largest, most comprehensive, fairest and that returns the most money to the pockets of our people, in all of our history. Because as we said before and proudly repeat today: 'a dollar in your hands yields much more than a dollar in the government's hands'.*

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Governor of the Commonwealth of Puerto Rico, Luis G. Fortuño[1]

Good friend, this event (Act 154), may be the last nail in the coffin.

Email by an anonymous top executive of the pharmaceutical industry[2]

I. INTRODUCTION

When the Governor of Puerto Rico, Luis G. Fortuño, pronounced the above-mentioned statement— given during his special message before a joint session of the Puerto Rico Senate and House of Representatives on October 25, 2010— he conveniently failed to mention which would be the revenue source that would be implemented to finance this new tax reform. However, just a couple of hours before announcing this new tax reform, the Governor had enacted into law Puerto Rico Act 154 of 2010 (hereinafter Act 154),[3] which modified several provisions of the Puerto Rico Internal Revenue Code of 1994[4] with the purpose of increasing income tax revenues. In contraposition, when the Governor expressed his view, he basically summed the worst fears of the manufacturing industry in Puerto Rico. Therefore, the wise words of Benjamin Franklin couldn't have had more relevance: "in the world nothing can be said to be certain except death and taxes."[5]

In summary, Act 154 modified the source of income rules in order to treat certain non-resident alien individuals, foreign corporations or partnerships as engaged in trade or business within Puerto Rico in order to tax them on certain transactions.[6] Act 154 also enacted a new excise tax on the acquisition of personal property and services. This article studies the technical aspects and effects of Act 154 on the tax incentives scheme that

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[1] LUIS G. FORTUÑO, GOVERNOR OF THE COMMONWEALTH OF PUERTO RICO, Mensaje Especial sobre La Reforma Contributiva, Salud para Todos y Más Dinero en tu Bolsillo [Special message regarding the Tax Reform, Healthcare for All and More Money in your Pockets], October 25, 2010, http://www.fortaleza.gobierno.pr/mensaje_gobernador/pdf/mensaje.pdf.

[2] Joanisabel González, *Píldora que atraganta la economía (The Pill that Chokes the Economy),* EL NUEVO DIA, October 31, 2010, http://www.elnuevodia.com/Xstatic/endi/template/imprimir.aspx?id=808566&t=3 (informing about the general provisions of PR Act 154, the lack of transparency in the approval process and the general discontent amongst the manufacturers in Puerto Rico).

[3] 2010 P.R. Laws No. 154; as amended by 2010 P.R. Laws No. 157.

[4] P.R. LAWS ANN. tit.13 § 8006 §§ 9750 (LexisNexis 2007).

[5] BENJAMIN FRANKLIN, LETTER TO JEAN-BAPTISTE LEROY (Nov. 13, 1789) *available at* http://www.scmidnightflyer.com/benf.html.

[6] 2010 P.R. Laws No. 154.

existed, which served as a stimulus for the Island's economic development. In light of these new developments, we analyze Puerto Rico's long history of tax driven incentives for economic development, the possible effects of Act 154 on our ability to further economic development derived from foreign investment in order to propose refocusing and restructuring our tax revenue polices in these times of global uncertainty.

Finally, it is extremely important to bear in mind that the new Source Rule and the Excise Tax are unusual statutory provisions. These were structured by a consulting firm hired by the local Government to be specifically applied to corporate and business structures, which resulted from the tax incentives schemes promoted by the Government for decades. The Source Rule and the Excise Tax effectively impose a tax on income earned as a result of production in Puerto Rico, instead of focusing on the income derived from the sale transactions of those products. In essence, the *Source Rule* does this by attributing to Puerto Rico, and thus subjecting to tax, a portion of the income earned by purchasing entities that resell goods manufactured in its jurisdiction. Consequently, the *Excise Tax* directly imposes a tax on the acquisition of goods by the purchasing entities from related entities that manufacture in Puerto Rico. This is an unusual practice, because most states seek to encourage local production while discouraging imports by imposing fewer taxes on local production and heavier taxes on sales within the state.[7]

Therefore, Act 154 was designed to pay for a tax reduction for Puerto Rican residents (individuals and corporations). As such, we will discuss the peculiarities of its relationship with the United States, which has in turn facilitated its establishment as a top destination for manufacturing, the specific technical provisions of Act 154, its possible impact on foreign manufacturing companies that operate in Puerto Rico, and the possibilities for future economic development, after the implementation of Act 154.

A. Puerto Rico's Primary Taxing Power: The Fiscal Autonomy of the Island

[7] *Tax And Business Incentives Overview The Lowest Effective Corporate Income Tax*, Puerto Rico Industrial Development Company, PRIDCO.COM (Jan. 26, 2011, 7:45 PM), http://www.pridco.com/english/tax_and_business_incentives/3.0tax_bus_incentives_overview.html#TaxModels (explaining that this was the logic followed previously by the Government when it stated that Puerto Rico provides unparalleled value that no other location can match. It is a United States community with a foreign tax structure. Here you can enjoy the benefits and protections of operating within a U.S. jurisdiction with the added tax benefits of operating under a Controlled Foreign Corporation (CFC) structure. Profits from sales to the U.S. mainland are free from U.S. taxation and goods enter the U.S. market duty-free. In addition, Puerto Rico offers a highly attractive incentives package that includes 100% exemption from multiple taxes; special treatment for pioneer industries and much more).

As exemplified by this section's title, Puerto Rico exercises a powerful tool in the form of primary taxing power. It is the primary taxing entity of the wealth generated within the Island. This primary taxing power arises from the constitutional developments that have characterized its relationship with the United States for more than a century.

As described by International Tax Professor Juan C. Méndez-Torres "on April 12, 1900, Congress approved an Organic Act for Puerto Rico, also known as the Foraker Act, which ended the military regime that had ruled the island and established a civil government. It also declared that the people of Puerto Rico were 'citizens of Puerto Rico.'"[8] Additionally, Tax Law Professor Carlos Díaz-Olivo has stated that:

> The Foraker Act itself established that the tariff of the Dingley Act would not be collected on any product interchanged between Puerto Rico and the United States as soon as the Legislative Assembly of Puerto Rico had put into operation a system of local taxation and would have notified the President of the United States. He, in turn, would issue a proclamation, thereof, terminating the said collection of duties. Acting according to the dispositions of the Organic Act, the Legislative Assembly of the Island established and put into operation on March 31, 1901, a system of local tax to defray the expenses of the Government upon the enactment of a law entitled: Act to Provide Income to the Government of Puerto Rico and for other purposes. The sources of income established by the Island Legislature when exercising for the first time its power to levy taxes were essentially three: a real and personal property tax, an inheritance tax, and a tax on tobacco, alcoholic beverages and other consumer products.[9]

Henceforth, "soon after the enactment of the Foraker Act, the United States Supreme Court held that, unlike Hawaii, Puerto Rico was not to be considered an incorporated territory in the formal sense as defined in the U.S. system of government."[10] The United States (hereinafter U.S.) Supreme Court further held that the tax uniformity clause of the U.S. Constitution is not applicable to the territory of Puerto Rico.[11]

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[8] Juan Carlos Méndez Torres, *The Internal Revenue Code's Role in Puerto Rico's Economic Development,* 15 J. INT'L TAX'N 22, 2 (2004), (commenting Act of March 24, 1900, ch. 91, 31 Stat. 51 (1900)).

[9] Carlos Díaz Olivo, *The Fiscal Relationship Between Puerto Rico and the United States: an Historical Analysis*, 51 Rev. Col. Abog. P.R. Núm. 2-3, 32 (1990).

[10] Méndez, *supra* note 6, at 2 (citing Downes v. Bidwell*,* 182 U.S. 244 (1901)).

[11] Downes v. Bidwell*,* 182 U.S. 244.

Thereafter, the U.S. "Congress on March 2, 1917, adopted another Organic Act for Puerto Rico, the Jones Act. It maintained the same relationship between the U.S. and Puerto Rico, but it granted U.S. citizenship to all persons born in Puerto Rico."[12] Looking at the statutory provision of the Jones Act, Professor Díaz-Olivo has indicated that:

> With the enactment of the Jones Act and the Revenue Act of 1917 a new chapter was begun in the history of the fiscal relationship between the United States and Puerto Rico. It is precisely during this period that the tax pattern, which has characterized our fiscal relations with the United States for the last 90 years, was fully established. Such pattern has been the fundamental basis of our aspirations for economic development. A special tax treatment exempting Puerto Rico from the application and extension of federal legislation regarding this matter, and the concession of authority to the Government of Puerto Rico for the enactment and application of its own tax laws assured a degree of fiscal autonomy.[13]

For this reason, only 10 years after the approval of the Jones Act, the U.S. Congress enacted The Butler Amendment:

> In 1927, the United States Congress expressly gave the Legislature of Puerto Rico the power to enact its own income tax law by adding the words 'income taxes' after the phrase 'taxes and assessments on property' in the first sentence of Section 301 of the Jones Act. After this amendment, Section 3 reads so far as pertinent: 'That no export duties shall be levied or collected on exports from Puerto Rico, but taxes and revenue, and license fee, and royalties for franchises, privileges, and concessions may be imposed for the purposes of the insular and municipal government, respectively, as may be provided and defined by the Legislature of Puerto Rico.'[14]

The next transcendental event took place "[o]n July 3, 1950, [when] Congress adopted Public Law 600 [stating] 'in the nature of a compact so that

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[12] Méndez, *supra* note 8, at 2 (citing 39 Stat. 951 (1917)).
[13] Díaz Olivo, *supra* note 7, at 44 (citing Romero, *The History of Federal Inconsistencies in the Treatment of Taxation of Income Derived from Puerto Rico by Individuals,* 53 REV. JUR. UPR 446, 455 (1984)).
[14] *Id.* at 53 (referencing Act of March 4, 1927, Ch. 503, §I, 44 Stat. 1418 (1927), 48 U.C.S. §741 (known as the Butler Amendment)).

the people of Puerto Rico may organize a government pursuant to a constitution of their own adoption.'[15] The importance of this Act was that it "established that, once effective, the new constitution would automatically repeal the sections of the Jones Act that dealt with local affairs. The remaining sections would remain effective and, together with Public Law 600, would be known as the Puerto Rico Federal Relations Act."[16] Specifically, "[t]he Federal Relations Act provides that federal internal revenue laws do not apply to Puerto Rico."[17] However, it is very important to note that this Act also established that "[t]he government of Puerto Rico is not allowed to enter into any kind of treaty with foreign countries and most, if not all, U.S. tax treaties and conventions with foreign countries specifically exclude Puerto Rico from their application."[18]

B. Puerto Rico and Industrial Development Incentives: Past and Present

As of today, "currently in Puerto Rico there are three different schemes of corporate taxation: (i) the scheme applicable to exempt corporations under the Incentives Acts, (ii) the scheme applicable to the so-called special corporations, such as hotels and agricultural businesses (iii) the scheme applicable to regular corporations, taxed at a maximum rate of 39 percent."[19]

We will take a look at the conditions that helped Puerto Rico establish itself as one of the fastest growing, high-tech industrial development centers in the world.[20] Basically, the system of tax incentives it put into place resulted from "the nature of the political relationship between the U.S. and Puerto Rico, Congress was willing for many years to enact tax incentive statutes to promote U.S. investment in the island."[21]

Throughout the years, the U.S. Congress set forth Internal Revenue Code "sections 931, 936, and 30A [which] provide tax incentives for domestic corporations engaged in business in Puerto Rico."[22] These were particularly useful to economic development efforts; they stimulated the development of

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[15] Méndez, *supra* note 8, at 2 (citing Act No. 600 of July 3, 1950, ch 446, 64 Stat. 319(1950)).
[16] *Id.*
[17] *Id.*
[18] *Id.*
[19] CENTER FOR THE NEW ECONOMY ("C.N.E."), *Commentaries given at the public hearings of the Joint Treasury Commissions of the Puerto Rico Senate and House of Representatives on January 11, 2011*, p. 3-4, (discussion of Puerto Rico House of Representatives Project 3070 proposed PR Internal Revenue Code of 2010), available at http://www.grupocne.org/publications/Ponencia_Proyecto_Reforma_Contributiva.pdf.
[20] Puerto Rico Industrial Development Company, The Manufacturing Powerhouse, http://www.pridco.com/english/overview/2.1pr_overview_powerhouse.html (last visited Jan. 27, 2011),
[21] Méndez, *supra* note 8, at 24.
[22] *Id.* (addressing the I.R.C of 1954 § 931(a)(repealed in part 1976), I.R.C of 1976 § 936(a)(as amended in 1982) and I.R.C § 30A(2006)).

labor-intensive manufacturing, which, in turn, helped ease the workforce's transition from agriculture, and prevented massive unemployment.[23] Hence, Puerto Rico enacted specific legislation affording industrial tax exemptions, which took advantage of the U.S. Internal Revenue code sections mentioned above. Since its first Industrial Development Act, enacted in 1953, Puerto Rico has had a history of over 60 years of capital investment promoted by its industrial development program.[24] Using this legislation, the Government established industrial tax exemption grant agreements with many corporations, which tended to be members of affiliated groups containing both, U.S. and non-U.S. subsidiaries.[25] At this point in time, the valid industrial tax exemption grants should have been granted pursuant to the Tax Incentives Act of 1998[26] and its successor, the Economic Incentives for the

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[23] Steven J. Davis & Luis A. Rivera-Batiz, *The Climate for Business Development and Employment Growth* in THE ECONOMY OF PUERTO RICO: RESTORING GROWTH 283 (Susan M. Collins et al. eds., 2006).

> In practice, section 936 tax subsidies proved most attractive to capital-intensive manufacturing industries that produce proprietary products with big price markups over marginal costs. Products of this type facilitate tax minimizing transfer process and profit shifting between jurisdictions with different effective tax rates.
>
> According to a study by the U.S. General Accounting Office…section 936 tax subsidies to U.S. corporations with Puerto Rican operations amounted to $2.6 billion in 1989, or 13 percent of Puerto Rico's GDP. One view is that subsidies of this magnitude profoundly influenced Puerto Rico's economy and industrial structure. Another view is that section 936 subsidies mainly reflect paper transactions with little impact on the Puerto Rican economy but with a high cost to the U.S. treasury.

[24] The first Industrial Incentives Act was 1953 P.R. Laws No. 6 of December 15, 1953, as amended, known as the "Industrial Tax Incentives Act of Puerto Rico of 1954" followed by 1978 P.R. Laws No. 26 of June 2, 1978, as amended, known as the "Industrial Tax Incentives Act of Puerto Rico of 1978", 1987 P.R. Laws No. 8 of January 24, 1987, as amended, known as the "Tax Incentives Act of Puerto Rico", 1997 P.R. Laws No. 135 of December 2, 1997, as amended, known as the "Tax Incentives Act of 1998" and the most recent installment of the Industrial Incentives chapter in Puerto Rico 2008 P.R. Laws No. 73 of May 28, 2008, as amended, known as the "Economic Incentives Act for the Development of Puerto Rico".

[25] Puerto Rico Industrial Development Company, Recommended Tax Structures, http://www.pridco.com/english/tax_&_business_incentives/tax_incentives/3.11rec_tax_structures.html (last visited Jan. 27, 2011, 1:15 PM) (stating that "many companies have established their operations in Puerto Rico as profit centers to take advantage of special tax provisions". It is explained that a "U.S. Parent, under the Controlled Foreign Corporation ("CFC") structure, the Puerto Rico subsidiary, which will generate a maximum corporate income tax rate of 7% with no withholding tax, may use these profits to fund their foreign operations including the Puerto Rico operations". In the case of the European Union Parent under the European parent model, the European Union ("EU") parent has an affiliate in the Netherlands who in turn owns the Puerto Rico Corporation).

[26] 1997 P.R. Laws No. 135.

Development of Puerto Rico Act of 2008.[27] In general, the tax exemption agreements made pursuant to these acts provide, among other incentives, a low, flat rate of income tax on specific types of income and reduced rates and exemptions with respect to certain Puerto Rico and municipal property taxes, license fees, and excise taxes.[28]

As informed by the Government, with respect to the macroeconomic indicators, Puerto Rico's "economy is centered on high value-added services and manufacturing. During 2009, the gross domestic product was nearly $95.7 billion, with a GDP per capita of over $24,000. As of February 2010, the labor force was around 1.3 million strong, of which some 1.1 million were employed."[29] Thus, it could be argued that one of the biggest drivers of these indicators is the industrial tax incentive scheme. Furthermore, the importance of the tax incentives scheme in Puerto Rico's development is illustrated by Mr. David P. Lewis', Chief Tax Executive of Eli Lilly & Company, remarks stating that Puerto Rico's taxation regime was a fundamental factor in his company's decision to invest in the Island.[30]

II. General Background Information: International Taxation

It is extremely important to note that "[a]t its most general, United States [and also Puerto Rico] international income tax law is a question of jurisdiction, specifically the questions of whether and to what extent the United States [and Puerto Rico] will assert income tax jurisdiction over items of income with respect to which another sovereign also could assert income tax jurisdiction."[31] As explained by the distinguished Professor Meade Emory:

> [U]nder United States [and Puerto Rico] tax law, international economic connections are broadly divided into two categories. The United States economic activities of foreign individuals and entities are classified as 'inbound' transactions while the foreign economic activities of U.S. individuals (based on

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[27] 2008 P.R. Laws No. 73.

[28] *See generally* Department of Economic Development and Commerce of the Government of Puerto Rico, A Guide to Doing Business in Puerto Rico (2010), http://www.pridco.com/pdf/aguidepr.pdf.

[29] *Id.* at 8. Puerto Rico Coastal Management Program, Draft Assessment and Strategies FY 2011-2015, 2-3, available at http://www.drna.gobierno/pr/oficinas/arn/recursosvivientes/costasreservasrefugios/pmz/.

[30] Davis P. Lewis, Vice President Global Taxes, Eli Lilly & Company, Remarks at the Conference of the Historical Foundation of the Supreme Court of Puerto Rico, the Foundation of the Federal Bar Association and its Fellows, and the Center for the New Economy: Economic Development and the Judicial Branch (Mar. 18, 2010).

[31] Meade Emory et al., *U.S. Tax Overview: Structure of the Federal Tax System of the United States*, 949 Tax Mgmt. (BNA) Foreign Income, (January 27, 2011).

> citizenship or residence) and U.S. corporations are classified as 'outbound' transactions. The United States imposes very different taxing regimes on these two classes of transactions. In general, the United States asserts broader taxing authority over the latter taxpayers (generally, 'U.S. persons') than it does over the former taxpayers (generally, 'foreign persons').
>
> Outbound transactions are generally subject to the principle of worldwide taxation under which the United States asserts the authority to tax all of the income of U.S. taxpayers from whatever source derived, subject to a foreign tax credit to mitigate double taxation. In contrast, inbound transactions — transactions in which foreign taxpayers earn U.S. source income — are subject largely to source-based taxation, under which the United States asserts jurisdiction over only U.S. source income. This regime is not the only alternative available; for example, France maintains a territorial system under which it asserts taxing jurisdiction over only domestic source income for all taxpayers.[32]

This statement illustrates how the fiscal taxing autonomy possessed by both, the U.S. and Puerto Rico, can be used to reach all sorts of income generated by their residents and non-residents. As such, on the forefront of the approval of Act 154, Puerto Rico decided to explicitly wield its fiscal taxing autonomy to reach new taxpayers that, until now, had been beyond its taxing reach. Imagine, for an instant, an enormous leviathan –not unlike the Greek Scylla–[33] reaching out from the Island, with huge tentacles towards the U.S. and other foreign jurisdictions, in order to seek out those[34] who are not located abroad and were thought as not having a direct presence in Puerto Rico.

III. PUERTO RICO ACT 154

A. Alternatives Analyzed

On February 4, 2010, a tax reform commission was appointed by the Governor and charged with the task of examining different alternatives to

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[32] *Id.*

[33] Homer, Book XII, The Odyssey, (Mar. 25, 2011, 2:04 p.m.), http://homer.classicauthors.net/odyssey/odyssey12.html.

[34] This pronoun includes natural and juridical persons (corporations, partnerships, estates and trusts).

quickly reform the Island's tax system.[35] Amongst the considerations appraised by the Commission, was whether Puerto Rico could change its corporate income tax in order to adopt a unitary system of combined reporting using some kind of apportionment formula.[36] It was thought that combined reporting could be applied to related corporations, which composed a group of related entities engaged in the same, single business.[37] The Commission concluded that combined reporting treated the group of corporations as one unitary business and calculated the income of that single business which would be subjected to tax, using an apportionment formula.[38]

Thus, the Commission preliminarily concluded that Puerto Rico could implement such a combined reporting for unitary groups and stated that its purposes would be to require the inclusion of an affiliate's portion of the income of such non-resident affiliate to taxation.[39] It stated that it was aware that such a system would enable imposing income tax on the group in its entirety, instead of on each corporation, as it was currently being applied.[40] This new alternative would result in applying Puerto Rico's current corporate income tax provisions to the groups of corporations, which operated as a unitary business. Its result would be subjecting to taxation part of the affiliate corporations' income generated while doing business in Puerto Rico, even when these had no physical presence or direct involvement in its jurisdiction.[41]

The Commission considered that if a unitary system was imposed, the corporations manufacturing products in Puerto Rico and their U.S. or foreign affiliates who were purchasing and reselling those products, would all be considered as part of a single business and the income subject to tax would be determined based on a series of factors computed by reference to the group as a whole.[42] However, the Commission concluded that the combined reporting and formulary apportionment methods contained inherent complexities and, as such, the impact of implementing it, given the limited enforcement resources of the Department of the Treasury of the

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[35] Yanira Hernández Cabiya, *Configurado el comité que redactará la reforma contributiva,* EL NUEVO DIA, February 4, 2010, http://www.elnuevodia.com/Xstatic/endi/template/imprimir.aspx?id=667979&t=3 (informing that such committee was composed of "attorney Xenia Vélez as Director of the Executive Committee . . . Representative Antonio Silva, Senator Migdalia Padilla; Secretary of the Treasury Juan Carlos Puig; the President of the Government Development Bank, Carlos García; Secretary of Economic Development, José Ramón Pérez Riera, and the Governor's Chief of Staff Marcos Rodríguez Ema).

[36] *See generally* 2010 P.R. Laws No. 154, Statement of Motives, at 1.

[37] *Id*. at 2.

[38] *Id*.

[39] *Id*.

[40] *Id*.

[41] *Id*. at 3.

[42] *Id*.

Commonwealth of Puerto Rico (hereinafter Department of the Treasury) would be detrimental to its tax system.[43] In particular, the Commission was concerned that its Department of the Treasury would be unable to locate and gather the information needed to apply such taxing methods in an effective manner, and that it would potentially create uncertainty regarding the amount and timing of the tax revenues to be collected.[44]

Based on these considerations, the Commission determined that instead of establishing a combined reporting and formulary apportionment system, Puerto Rico should tax the income of company's affiliates that did business and engaged in substantial transactions with manufacturers in Puerto Rico.[45] Therefore, instead of adopting a system of corporate income tax, which took on the group as a whole, it purported to change the way individual corporations that performed certain activities as members of a unitary business structure were being taxed.[46] To accomplish this, Puerto Rico would have to adopt a modified income source rule and a new excise tax that would apply in certain situations in lieu of the new modified source rule.[47]

B. The Approval Process and Immediate Concerns

"The Government of Puerto Rico kept the contents of this legislation strictly confidential until October 22, 2010, when the Legislature of Puerto Rico unveiled a substitutive bill to House Bill 2526."[48] Shortly thereafter, "[o]n October 23, 2010, the Government of Puerto Rico, represented by [various high ranking officials], and the Government's external counsel on this matter [the Washington DC law firm of Steptoe & Johnson LLP], held a meeting with a small group of Puerto Rico tax practitioners, . . . to explain the new statute.".[49] From the get-go, it seems that the principal strategy followed by the Government was to sell the idea that the newly legislated tax could qualify as credit against U.S. federal income tax by arguing that it could meet the requirements of an *in lieu of tax* under section 903 of the Internal revenue Code of 1986.[50] However,

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[43] *Id*.
[44] *Id*.
[45] *Id*. at 4.
[46] *Id*.
[47] *Id*.
[48] *New Puerto Rico Taxes on Certain Foreign Corporations,* McCONNELL VALDÉS TAX ALERT, (McConnell Valdés LLC, San Juan, P.R.), Oct. 25, 2010, at 3, http://www.mcvpr.com/CM/McVAlerts/New-Puerto-Rico-Taxes-on-Certain-Foreign-Corporations.pdf.
[49] McCONNELL VALDÉS TAX ALERT, *supra* note 47, at 3.
[50] *Id.* at 3. *See also* Steptoe & Johnson LLP, Legal Opinion: Creditability of Excise Tax requested by The Government of Puerto Rico (October 25, 2010) (on file with author).

> [t]he big picture is that the tax is intended for local manufacturers, but since the government cannot tax local manufacturers because the tax treatment of those entities is frozen under a tax exemption grant, the only way to raise taxes is to tax through mechanisms which impose the tax on affiliates who are purchasing the local production.[51]

The backlash generated by the general public, industry and private practitioners quickly followed once it was made public that House Bill 2526 was enacted into law roughly two (2) days after its submission and just in time for the Governor's special message regarding tax reform. The President and CEO of the National Association of Manufacturers indicated

> [w]e are alarmed by the actions taken by the Puerto Rican government to impose a new excise tax on multinational manufacturers. Over the years, U.S.-based manufacturers have invested in Puerto Rico, most notably in the chemical, pharmaceutical and biotechnology industries. They represent approximately 80 percent of all the manufacturing jobs in Puerto Rico and nearly 26 percent of Puerto Rico's gross domestic product (GDP). The imposition of this tax could jeopardize the jobs of over 100,000 people and could damage business relationships that have taken years to develop between the affected companies and the government of Puerto Rico.
>
> Even more concerning was that this law was passed in a period of 48 hours with no public hearings. By increasing costs for these manufacturers, the Puerto Rican government is jeopardizing jobs and economic growth at a time when our global economy is struggling to recover from a crippling recession.[52]

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[51] Liz Bearese, *Manufacturing tax in Puerto Rico to discourage US and EU investments*, International Tax Review (Nov. 5 2010) (citing CPA Felipe Mariani from Zaragoza and Alvarado), *available at* http://www.internationaltaxreview.com/Article/2712087/Manufacturing-tax-in-Puerto-Rico-todiscourage-US-and-EU-investments.html.

[52] The National Association of Manufacturers (NAM), Manufacturers Oppose Puerto Rico's New Tax Increase on Multinational Companies, Press Release, (Oct. 27, 2010), http://www.nam.org/Communications/Articles/2010/10/Manufacturers-Oppose-Puerto-Rico.aspx.

Furthermore, John Castellani, president of Pharmaceutical Research and Manufacturers of America (hereinafter PhRMA), released a statement expressing opposition to the law because it "could significantly reduce the ability of PhRMA's members to operate in the Commonwealth."[53] PhRMA's press release also highlighted that "[t]he biopharmaceutical research sector has supported a total of 94,217 jobs and $3.6 billion in output in Puerto Rico, according to the latest survey conducted in 2006."[54]

Local criticisms were also very specific, regarding the lack of public participation in the development and subsequent adoption of Act 154. For example, the Puerto Rico Society of Certified Public Accountants expressed:

> [w]e further understand, as has been reported in the press and by the Government of Puerto Rico, that the proposed tax reform will be financed primarily, by the revenues generated by Act 154, which imposes a special tax on certain foreign companies that meet specific requirements. We would like to point out that during the legislative process for approval of this Act 154 the Puerto Rico State Society of CPAs was not offered the opportunity to thoroughly analyze the particularities of the Act and its impact on Puerto Rico, however we understand prudent to point out our concern (which is the same for many other organizations in Puerto Rico) on the impact that the Act might have on one of the most important economic sectors of our country, manufacturing.[55]

Also, Mr. Pedro Watlington, President of the Puerto Rico Manufacturers Association denounced that

> the imposition of 4% excise tax to corporations is a measure that poses a serious detriment to the competitiveness of businesses in Puerto Rico and results in a critical situation that will lead to halt expansion plans, the exit of some companies from the island, and serious impact on the supply chain

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[53] Press Release, Pharmaceutical Research and Manufacturers of America (PhRMA), PhRMA Statement Regarding Puerto Rico Law 154, Press Release, (Oct. 27, 2010), http://www.phrma.org/node/356.

[54] *Id.*

[55] Puerto Rico Society of Certified Public Accountants, Recommendations given at the public hearings of the Joint Treasury Commissions of the Puerto Rico Senate and House of Representatives on December 21, 2010 (discussion of Puerto Rico House of Representatives Project 3070 proposed PR Internal Revenue Code of 2010), *available at* http://www.colegiocpa.com/download.php?id=2691.

> composed of local Puerto Rican manufacturing companies and service providers.[56]

Moreover, it was cautioned that "[w]ithout having collected the first penny of the excise tax, Act 154 'accelerated' any decision-making process connected with the local manufacturing operations [established in Puerto Rico]. The Government 'has gone around' the contracts and tax exemption decrees signed or renegotiated with dozens of multinational corporations."[57] The unfortunate thing, according to Edgardo Fábregas, is that Act 154 and its precipitated adoption denote a Puerto Rico that decided to *opt out*, as the measure casts a shadow over the Government's commitment to the sector and virtually ends the industrial promotion strategy.[58]

The purpose of this section was to highlight the enormous backlash — from industry executives and private practitioners— that ensued immediately after the approval of Act 154 was announced. However, this counter-blast was more than mere bickering from industry leaders and private practitioners. This up-spur of public opinion exemplifies the degree of discomfort and instability that continues to impact the general business environment in Puerto Rico. What were once viewed as unchangeable, *e.g.* income tax exemption decrees, have now become mere legal texts that can be side stepped through the use of loophole legislation, such as Act 154.

C. Technical Aspects: Discussion of the Mechanics of Act 154

1. Approval of the Internal Revenue Code for a New Puerto Rico

On January 31, 2011, a new Internal Revenue Code for Puerto Rico was signed into law and became known as the Internal Revenue Code for a New Puerto Rico (hereinafter the 2011 Internal Revenue Code for Puerto Rico Code). With certain exceptions, the 2011 Internal Revenue Code for Puerto Rico Code came into effect as of January 1, 2011 (i.e. for taxable years commenced after December 31, 2010). However, section 1035.05 of the 2011 Internal Revenue Code for Puerto Rico Code specifically sets forth that, for purposes of determining the income, gain or loss to be treated as effectively connected with the operation of a trade or business in Puerto Rico, the rules provided in subsection (f) and the definitions established in subsection (h) of

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[56] Puerto Rico Manufacturers Association, Industriales Presentan Recomendaciones Sobre Reforma Contributiva, Press Release, (Oct. 27, 2010), *available at* http://www.prma.com/pages/LegislationNews/RECOMENDACIONESSOBRE REFORMACONTRIBUTIVA.aspx.

[57] Joanisabel González, *supra* note 2, at 3 (referencing comments made by Carlos Serrano, ex Assistant Secretary for Internal Revenue for the Puerto Rico Treasury Department).

[58] *Id.*

Section 1123 of Act No. 120 of October 31, 1994, as amended, known as the "Puerto Rico Internal Revenue Code of 1994," in effect as of the date of enactment of this Code, shall apply. Additionally, section 3070.01 of the 2011 Internal Revenue Code for Puerto Rico Code states that the provisions related with excise tax on the acquisition of personal property and services made after December 31, 2010 among related persons shall be provided in Sections 2101, 2102, 2103, 2104 and 2105 of Act No. 120 of October 31, 1994, as amended, effective on the date of enactment of the 2011 Internal Revenue Code for Puerto Rico Code.

2. Modified Effectively Connected Income and Source Rule

The most important concept introduced by the modified effectively connected income and source rule is that it treats the activities of those related to a nonresident individual, foreign corporation, or partnership as an office or fixed place of business of a nonresident individual, foreign corporation or partnership in Puerto Rico.[59] This is an enormous change from previous provisions of the Puerto Rico Internal Revenue Code. Up to this point, the activities of a related person in Puerto Rico had been treated as an office or fixed place of business of a nonresident individual, foreign corporation, or partnership when that related person regularly exercised the authority to negotiate and conclude contracts or had a stock of merchandise from which he regularly filled orders, on behalf of the nonresident individual, foreign corporation, or partnership.[60] As a result, the modified effectively connected income and source rule broadens the situations when a related person shall be regarded as an office of fixed place of business of a nonresident individual, foreign corporation, or partnership. Specifically, it establishes additional conditions under which certain transactions between the related party and the nonresident individual, foreign corporation, or partnership are considered as occurring in an office or fixed place of business.[61] When the requirements are satisfied, the modified effectively connected income and source rule treats a portion of the income of certain activities of the nonresident as Puerto Rico source income.[62] Consequently, a portion of the income is treated as effectively connected with the execution of a trade or business in Puerto Rico and is subject to its taxation.[63]

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[59] 2010 P.R. Laws No. 154 (amending P.R. I.R.C. §1123(f) by adding §1123(f)(1)(A) and subsequent §§). These new sections set forth the new rules for the application of amended §1123(f)).
[60] Puerto Rico Revenue Code (P.R.I.R.C.), P.R. LAWS ANN. tit. 13 § 8523(f)(3)(B) (LexisNexis 2007).
[61] 2010 P.R. Laws No. 154 (P.R. I.R.C. §1123(f)(4)(A)).
[62] *Id*.
[63] *Id*.

In practice, the modified effectively connected income and source rule strives to achieve two things. First of all, the source rule expands the scope of *office or fixed place of business* by providing that a nonresident alien individual, corporation, or partnership will be treated as having an office or fixed place of business in Puerto Rico as a result of transactions above a certain threshold with a related party.[64] Second, the modified effectively connected income and source rule expands the scope of source income to provide that a portion of the income earned by the nonresident alien individual, corporation, or partnership shall be treated as Puerto Rico source income, and therefore be subjected to taxation as income effectively connected with the conduct of a trade or business in Puerto Rico.[65]

The modified effectively connected income and source rules provide that the office or fixed place of business of a person in Puerto Rico will be considered as the office or fixed place of business of a foreign entity when it: (i) has authority to negotiate and conclude contracts on behalf of the foreign entity, provided it is not a general commission agent, broker, or other agent of independent status acting in the ordinary course of his business,[66] or; (ii) is a member of the same controlled group as the foreign entity, and for the taxable year or any of the three (3) preceding taxable years satisfies one of following thresholds:[67]

> (i) Total Gross Receipts: If at least ten percent (10%) of the gross receipts of the person in Puerto Rico arises from the sale of personal property manufactured in Puerto Rico to, or from the performance of services in Puerto Rico for or on behalf of, the foreign entity.[68]
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> (ii) Total Cost: If the sales of personal property manufactured in Puerto Rico, or the performance of services in Puerto Rico for or on behalf of, the foreign entity, account for at least ten percent (10%) of the cost of the total personal property or services purchased by the foreign entity.[69]
>
> (iii) Total Commissions and Fees: If the commissions or fees earned by the foreign entity from transactions related to personal property manufactured in Puerto Rico or services

[64] *Id*.
[65] *Id*.
[66] *Id*. at P.R. I.R.C. §1123(f)(4)(A)(i)(I).
[67] *Id*. at P.R. I.R.C. §1123(f)(4)(A)(i)(II).
[68] *Id*. at P.R. I.R.C. §1123(f)(4)(A)(ii)(a)
[69] *Id*. at P.R. I.R.C. §1123(f)(4)(A)(ii)(b).

> performed by the other person in Puerto Rico represent at least ten percent (10%) of the total commissions or fees earned from similar transactions.[70]
>
> (iv) Facilitation Analysis: If the foreign entity facilitates the sale of personal property manufactured in Puerto Rico or the performance of services by the person in Puerto Rico, and such sales or services, when considered with the activities described above, account for at least: (a) ten percent (10%) of the total gross receipts of the person in Puerto Rico; or (b) ten percent (10%) of the total gross receipts of the foreign entity from similar facilitation services.[71]

If the aforementioned thresholds are met, the foreign entity will be deemed as engaged in a trade or business in Puerto Rico and a portion of its income, gains, and profits will be treated as Puerto Rico source effectively connected income.[72] The portion of source effectively connected income will be determined based on a formula that considers four (4) factors: payroll, property, sales, and purchases.[73]

The percentage is computed by taking an average of four fractions: (i) property in Puerto Rico divided by total property;[74] (ii) Puerto Rico payroll divided by total payroll;[75] (iii) sales in Puerto Rico divided by total sales;[76] and (iv) purchases in Puerto Rico divided by total purchases.[77] The resulting sum of these fractions is divided by four and multiplied by the purchaser's total income in order to determine the Puerto Rico source income.[78] Act 154 provides that, if any taxpayer believes that the apportionment to Puerto Rico determined under the formula results in a greater portion of its total income than is reasonably attributable to business or sources within it, the purchaser may file a statement of objections proposing an alternative method of apportionment it considers appropriate, under the circumstances.[79] Additionally, Act 154 provides a simpler calculation for cases in which a purchaser is unwilling or unable to adequately document the required information for the application of the four factors and if he is unable to

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[70] *Id*. at P.R. I.R.C. §1123(f)(4)(A)(ii)(c).
[71] *Id*. at P.R. I.R.C. §1123(f)(4)(A)(ii)(d).
[72] *Id*. at P.R. I.R.C. §1123(f)(4)(B)(i).
[73] *Id*. at P.R. I.R.C. §1123(f)(4)(B)(v).
[74] *Id*. at P.R. I.R.C.§1123(f)(4)(B)(v)(I).
[75] *Id*. at P.R. I.R.C. §1123(f)(4)(B)(v)(II).
[76] *Id*. at P.R. I.R.C. §1123(f)(4)(B)(v)(III).
[77] *Id*. at P.R. I.R.C. §1123(f)(4)(B)(v)(IV).
[78] *Id*. at P.R. I.R.C. §1123(f)(4)(B)(v).
[79] *Id*. at P.R. I.R.C. §1123(f)(4)(B)(vi).

demonstrate a viable alternative formula or method.[80] The alternative calculation treats 50 percent (50%) of the income from the sale or exchange of property manufactured or produced in whole or in part within Puerto Rico as sourced where it is manufactured or produced; in this case, Puerto Rico.[81]

It is important to note that, for the very first time in history, the Puerto Rico Internal Revenue Code has been amended to include an *anti-abuse rule* that restricts a taxpayer's discretion to structure transactions in order to limit their tax consequences. The modified effectively connected income and source rule contains an anti-abuse rule stating that any transaction or series of transactions, where one of their principal purposes is the avoidance of any of the 10 percent (10%) tests described above, will be disregarded.[82] Therefore, this *anti-abuse rule* was adopted in hopes of limiting taxpayer's discretion in structuring transactions so as to avoid the application of the modified effectively connected income and source rule. Thus, Act 154 ensures a fixed stream of tax revenues.

The modified effectively connected income and source rule, as stated by Act 154, applies to income accrued after December 31, 2010,[83] but these do not contain any expiration or *sunset* provision. Hence, we understand that both of these methods will become a permanent change to Puerto Rico's taxation laws.

3. Excise Tax on the Acquisition of Property and Services from Related Parties

The Commission explained that the idea behind adopting a separate excise tax on the acquisition of personal property and services among related parties responds to the concern that the Department of Treasury would lack sufficient resources to effectively enforce the modified effectively connected income and source rule.[84] Additionally, it concluded that the inability to correctly enforce the modified effectively connected income and source rule would result in a significant revenue loss from taxpayers with substantial volumes of purchases from Puerto Rico related parties engaged in manufacturing.[85]

The new excise tax applies, in lieu of the income tax that would otherwise result from the application of the amended effectively connected income and source rule, when gross receipts from the sale of personal property manufactured in or services performed in Puerto Rico exceed

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[80] *Id*. at P.R. I.R.C. §1123(f)(4)(B)(vii).
[81] *Id.*
[82] *Id*. at P.R. I.R.C. §1123(f)(4)(B)(iv).
[83] 2010 P.R. Laws No. 154, article 5.
[84] *See generally* 2010 P.R. Laws No. 154, Statement of Motives, at 4.
[85] *Id*.

$75,000,000 for any of the three (3) preceding taxable years.[86] The base amount for imposing the excise tax will be the value of the personal property and services acquired in Puerto Rico by the foreign entity after December 31, 2010.[87] Such value will be determined according to the invoice rendered for such items and, in the absence of an invoice, the tax shall be based on the fair market value of the items.[88] The excise tax is imposed on, and will be a liability of, the person acquiring such personal property and services, and the Secretary of the Department of Treasury (hereinafter Secretary) has the authority to prescribe regulations to prevent duplicative collection of such tax.[89]

However, the person receiving any consideration for personal property or services in a transaction must collect the tax and deposit it with the Secretary or any authorized financial institution on or before the fifteenth (15th) day of the month after the transaction took place.[90] Furthermore, such person must file quarterly returns with the Department of Treasury and penalties apply in case of non-compliance.[91]

The excise tax is temporary and it encompasses a period of six (6) years that will phase out as follows: four percent (4%) for acquisitions occurring after December 31, 2010 and before January 1, 2012; three and three quarters percent (3.75%) for acquisitions occurring after December 31, 2011 and before January 1, 2013; two and three quarters percent (2.75%) for acquisitions occurring after December 31, 2012 and before January 1, 2014; two and one half percent (2.5%) for acquisitions occurring after December 31, 2013 and before January 1, 2015; two and one quarter percent (2.25%) for acquisitions occurring after December 31, 2014 and before January 1, 2016; and one percent (1%) for acquisitions occurring after December 31, 2015 and before January 1, 2017.[92]

4. Relevant Concepts found in the Regulations applicable to the Excise Tax

The tax applies to the acquisition of personal property and services by one member of a controlled group of corporation[93] from another member with manufacturing operations in Puerto Rico and with gross receipts in excess of $75,000,000 for any of the three (3) preceding tax years.[94]

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[86] P.R. I.R.C. §1123(f)(4)(B)(iii)(I).
[87] 2010 P.R. Laws No. 154 (P.R. I.R.C. §2101(a)(1)).
[88] *Id*. at P.R. I.R.C. §2101(a)(1).
[89] *Id*. at P.R. I.R.C. §2101(a)(2).
[90] 2010 P.R. Laws No. 154 (P.R. I.R.C. §2102(a)).
[91] *Id*. at P.R. I.R.C. §2102(b).
[92] 2010 P.R. Laws No. 154 (P.R. I.R.C. §2102(b)(4)).
[93] P.R. LAWS ANN. tit. 13 § 8428 (P.R. I.R.C. §1028 defining the term "corporations or partnerships controlled groups).
[94] Puerto Rico Regulation 7970, P.R. I.R.C. Regulation § 2101(a)-1(a).

Additionally, the regulation defines personal property and services as tangible property manufactured or produced in whole or in part and services performed in Puerto Rico in connection with the manufacture or production of tangible property.[95] A person is treated as having manufactured or produced tangible property in Puerto Rico if: (i) the assembly or conversion costs account for twenty percent (20%) or more of the total sale price;[96] (ii) employees or contractors substantially transform the property in Puerto Rico;[97] (iii) the product is produced or manufactured under industrial incentives legislation, including the Puerto Rico Economic Development Incentives Act of 2008, the Tax Incentives Act of 1998, the Tax Incentives Act of 1987, or the Industrial Incentives Act of 1978.[98]

The regulation also defines *acquisition* as "any action, transaction, or series of actions or transactions by which any person or enterprise (i) obtains or procures legal ownership or physical possession of tangible property, or (ii) obtains or procures the benefit of services."[99] It includes the electronic transmission or communication of a computer program from a location in Puerto Rico.[100] It further establishes that an acquisition occurs on the day on which the tangible property is acquired, transmitted, communicated, or first loaded onto a vehicle or placed in the custody of a common carrier for transportation from the manufacturer or producer in Puerto Rico.[101] The value of personal property and services is determined by the regulations. These consider the following factors: (i) bill for property or services: the price it shows, assuming other bills do not reflect different prices for the same good or service;[102] (ii) fair market value: the value established for tax reporting purposes (if no bill exists);[103] (iii) exclusion of separately priced publicly traded components: the value recorded in financial records;[104] (iv) acquisition of services: the value of the personal property to which the services relate, not the services themselves;[105] (v) transfer pricing adjustments: allowable, if they reflect fair market value.[106]

The regulation allows for credits that could be used to provide partial relief from the excise tax or, in some cases, eliminate the tax in its entirety.[107]

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[95] *Id*. at P.R. I.R.C. Regulation § 2101(a)-1(c).
[96] *Id*. at P.R. I.R.C. Regulation § 2101(a)-1(c)(3)(i).
[97] *Id*. at P.R. I.R.C. Regulation § 2101(a)-1(c)(3)(ii).
[98] *Id*. at P.R. I.R.C. Regulation § 2101(a)-1(c)(3)(iii).
[99] *Id*. at P.R. I.R.C. Regulation § 2101(b)-1(a)(1).
[100] Puerto Rico Regulation 7970, P.R. I.R.C. Regulation § 2101(b)-1(a).
[101] *Id*. at P.R. I.R.C. Regulation § 2101(b)-1(b).
[102] Puerto Rico Regulation 7970, P.R. I.R.C. Regulation § 2101(b)-2(a)(1).
[103] *Id*. at P.R. I.R.C. Regulation § 2101(b)-2(a)(2).
[104] *Id*. at P.R. I.R.C. Regulation § 2101(b)-2(a)(3).
[105] *Id*. at P.R. I.R.C. Regulation § 2101(b)-2(a)(4).
[106] *Id*. at P.R. I.R.C. Regulation § 2101(b)-2(a)(5).
[107] Puerto Rico Regulation 7970, P.R. I.R.C. Regulation § 2102(a)-2(a).

Credits that may offset the excise tax include: (1) a general credit against the excise tax of $4,000,000.00 in 2011; after 2011, the excise tax rate is divided by 4% times $4,000,000.00. Unused credits may not be carried forward, backward, or refunded;[108] (2) an alternative credit based on gross receipts, in lieu of the general credit; a controlled group may elect this credit and, if it meets certain conditions, the credit begins at $7,000,000.00 in 2011, but reduces each year thereafter;[109] (3) an alternative credit in cases where taxable acquisitions exceed certain thresholds. Some controlled groups with taxable acquisitions of $4,000,000,000.00 or more and that employ 500 employees or more with a payroll of $20,000,000.00 may elect this credit. For 2011, the amount of the credit varies from $20,000,000.00 to $80,000,000.00, based on the dollar amount of taxable acquisitions.[110] In addition to alternative credit for incremental increase in employees, the regulation provides an additional credit that may apply if the number of persons employed by the controlled group in Puerto Rico exceeds 500 by at least 100. This credit applies for companies with taxable acquisitions in excess of $4,000,000,000.00.[111] Also, the regulations state that a controlled group that has members engaged in manufacturing and production or manufacturing services in facilities located in three or more municipalities and employing more than 50 people, may be eligible for a credit of $3,000,000.00 per municipality, up to a maximum of $15,000,000.00.[112]

The two last credits set forth by the regulation include a credit for minority suppliers and a credit for knowledge corridor and research and development investment. The first credit applies if a controlled group directly purchases seventy-five percent (75%) or more of its goods or services from an approved minority business, it may be eligible for a credit based on how much of these exceeded the average annual amount purchased from minority businesses during the preceding two years.[113] For the second credit, a controlled group may be eligible based on its contributions to the Puerto Rico Science, Technology and Research Trust or to the Special Economic Development Fund. A cap of one or two percent (1 or 2%) of the excise tax would apply.[114]

Finally, the regulation states that the maximum excise tax amount imposed by Section 2101 for a calendar year, on all of the members of a controlled group that make taxable acquisitions, shall not exceed $375,000,000.00, except for the Economically Disadvantaged or Critical

[108] *Id*. at P.R. I.R.C. Regulation § 2102(a)-2(b).
[109] *Id*. at P.R. I.R.C. Regulation § 2102(a)-2(c).
[110] *Id*. at P.R. I.R.C. Regulation § 2102(a)-2(d).
[111] *Id*. at P.R. I.R.C. Regulation § 2102(a)-2(e).
[112] *Id*. at P.R. I.R.C. Regulation § 2102(a)-2(f).
[113] *Id*. at P.R. I.R.C. Regulation § 2102(a)-2(g).
[114] *Id*. at P.R. I.R.C. Regulation § 2102(a)-2(h).

Industry Suppliers credit and the Knowledge Corridor and Research and Development Investment credit.[115]

5. Creditability of Act 154 Excise Tax

The Internal Revenue Service (hereinafter I.R.S.) issued Notice 2011-29 aiming on addressing the creditability of the excise tax enactment by Act 154.[116] The IRS explained through Notice 2011-29 that "it has been the position of the Government of Puerto Rico that the excise tax is a tax imposed in substitution of the generally imposed income tax and that, as such, under Section 903 of the US Code, US taxpayers can claim a foreign tax credit for amounts paid."[117]

Consequently, the I.R.S. stated in notice 2011-29 that "the determination of the creditability of the excise tax requires the resolution of a number of legal and factual issues."[118] Furthermore the notice states that "pending the resolution of these issues, the I.R.S. will not challenge a taxpayer's position that the excise tax is a tax in lieu of an income tax under section 903."[119] Additionally the I.R.S. stated that the notice is effective for excise tax paid or accrued on or after January 1, 2011 and that any change in the foreign tax credit treatment of the excise tax after resolution of the pending issues will be prospective, and will apply to excise tax paid or accrued after the date that further guidance is issued."[120]

It must be noted that the language used by the I.R.S. in Notice 2011-29 is extremely vague and conditional. In essence, the I.R.S. will stand down and allow the excise tax to be credited as a foreign tax paid "in lieu of income tax" until the courts and other administrative agencies review the provisions of Act 154 and issue their rulings on this matter. Therefore, acknowledging the uncertainty that this notice creates, the I.R.S. agreed to allow the excise tax paid to be claimed as a credit and consequently, any changes in this position will be enforced prospectively. Thus, this issue continues to be unresolved and open to numerous challenges in the courts of Puerto Rico and the United States, where Act 154's constitutionality can be questioned in several ways.

D. Unanswered Concerns: The "Twilight Zones" in Act 154

Since there were no public hearings or debates regarding Act 154, there remain many unanswered questions about its new rules. Firstly,

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[115] Puerto Rico Regulation 7970, P.R. I.R.C. Regulation § 2102(a)-3(a).
[116] Puerto Rican Excise Tax Notice 2011–29, 2011-16 I.R.B 663-664.
[117] *Id.* at 663.
[118] *Id.* at 664.
[119] *Id.*
[120] *Id.*

> [t]his is a new tax that is not in accord with international norms. Taxpayers that have subsidiaries that manufacture in Puerto Rico were disappointed that Puerto Rico even considered such a tax. The government of Puerto Rico apparently believed the tax would be funded through the U.S. foreign tax credit system.[121]

Therefore, we can conclude that the creditability of the tax will not even be considered, for some taxpayers with manufacturing subsidiaries in Puerto Rico. For these, the tax will simply be deemed as an additional direct cost of manufacturing in Puerto Rico.[122]

Secondly, it is yet to be seen how the U.S. Treasury and the Internal Revenue Service will view the creditability of the tax as a foreign tax credit for U.S. tax purposes or, in the case of the excise tax, as a section 903 *tax in lieu* of an income tax.[123] Also, we must be vigilant of any lawsuits presenting issues regarding the tax's constitutionality. Thus, questions could arise regarding nexus, due process, and the inter-state commerce clause.[124]

Thirdly, the creditability of the tax as a foreign tax credit may be of little interest to taxpayers, when the tax is imposed on a non-U.S. corporation such as a foreign parent company or the Controlled Foreign Corporations (CFC) of a U.S. parent company that purchases goods from a manufacturing company in Puerto Rico.[125] For those companies, the tax will simply be a direct cost of manufacturing in Puerto Rico. Additionally, "numerous collateral issues can also arise, such as constructive dividends and section 956 investments, when the company on whom the tax is imposed fails to reimburse the company that manufactured the products in Puerto Rico and then paid the excise tax."[126]

As a fourth consequence, it is unclear whether the new source rule and excise tax are consistent with tax grants that companies had previously negotiated with the Puerto Rico Government.[127] Entities currently operating

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[121] JAMES P. FULLER, et al., U.S. International Tax Developments, (2011) at 32, *available at* http://www.ifausa.org/dman/Document.phx/Events/%5Eeman.208/Conference+Handouts/US+International+Tax+Developments?folderId=Events%2F%255Eeman.208%2FConference%2BHandouts&cmd=download.

[122] *Id.*

[123] *Id.*

[124] *Id.*

[125] *Id.*

[126] JAMES P. FULLER, *supra* note 118. (In reference to constructive dividends and section 956 investments). *See also* I.R.C § 956 (2006) (dealing investment of earnings in United States property).

[127] PRICEWATERHOUSECOOPERS LLP, *Puerto Rico enacts new temporary excise tax on offshore manufacturers, permanent change in source-of-income rule*, INDUSTRIAL PRODUCTS & SERVICES TAX ALERT (Nov. 30, 2010) *available at*

in Puerto Rico that enjoy tax exemptions should not see their tax benefits affected. The new excise tax and sourcing rules should apply only to related foreign corporations. However, at the consolidated level, the tax could represent a significant increase in effective tax rate for the Puerto Rico jurisdiction.[128]

In fifth place, "Act 154 does not address the effect and treatment of transfer pricing adjustments introduced at year-end related to the new excise tax".[129] Neither does it specifically address the compliance requirements applicable to foreign corporations deemed to be engaged in a trade or business in Puerto Rico by virtue of the amended provisions related to sources of income. Furthermore, the effect that the Act might have on other Puerto Rico filing requirements is yet to be determined.[130] Additionally, Act 154 fails to address the volume of business tax implications that could result from the new effectively connected rules.

Finally, it is relevant to bear in mind that there are various tax accounting and financial reporting complications that must be addressed if Act 154 is to be imposed. Specifically, "[t]he key accounting question surrounding this new tax is determining whether it is within the scope of ASC 740, *Taxes,* or other accounting guidance."[131] As such, it must be noted that:

> The principles of ASC 740 are applicable to 'taxes based on income.' However, authoritative literature under US GAAP does not clearly define the term 'tax based on income' or differentiate taxes based on income from taxes that are not. In practice, the general rule is that a tax would qualify as 'tax based on income' when revenues or receipts are reduced by at least one category of expense. Thus, implicit in ASC 740 is the concept that taxes on income are determined after revenues and gains are reduced by expenses, and losses respectively. A

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http://www.publications.pwc.com/DisplayFile.aspx?Attachmentid=3968&Mailinstanceid=18824.

[128] *Id.* at 3.

[129] *Id.* at 4.

[130] *Id.*

[131] PRICEWATERHOUSECOOPERS LLP, *Puerto Rico's Excise Tax: New Regulations and Accounting Considerations*, PHARMA AND LIFE SCIENCES TAX NEWS, Vol. 9, No. 13 (Oct. 13, 2010) *available at* http://www.pwc.com/gx/en/pharma-life-sciences/pdf/ptn_vol9no18.pdf. Regarding XXX, refer to Generally Accepted Accounting Principles (GAAP), Accounting Standards Codification 740 Income Taxes Topic addresses financial accounting and reporting for the effects of income taxes that result from an entity's activities during the current and preceding years.

tax solely based on gross amounts such as revenue/receipts or purchases would generally not qualify as an income tax.[132]

IV. Conclusions: Are We at the Border of the Cliff?

It is amazing to see how much things can change in a relatively short amount of time. Just a couple of months ago, the following statement made sense: "[t]he competition to attract companies setting up new manufacturing facilities is also rising. Ireland and Puerto Rico have established particularly strong manufacturing bases, thanks to corporate income tax rates of 12.5% and 20%, respectively."[133] A description that's offered, for example, about Ireland's tax incentives is that "[w]ith its 12.5% corporate tax rate and highly educated populace, Ireland has attracted numerous pharmaceutical companies."[134] Whereas Puerto Rico has been described as "low corporate tax rate and off-shore status have stimulated a large pharmaceutical manufacturing presence. Most of the big players, including AstraZeneca, GlaxoSmithKline, Johnson & Johnson, Lilly, Merck & Co. and Pfizer have plants there."[135]

This statement came from a report, which also states that "for the past 20 years, Pharma has benefited from a benign legislative and commercial environment that has enabled it to report low and stable tax rates."[136] It also emphasizes that "Governments have permitted the use of low-tax jurisdictions, and the industry has been able to demonstrate that a large portion of the profit it earns comes from the intellectual property it creates – much of which is located in low-tax countries."[137] Furthermore, the report proclaims that the economic prospects of the pharmaceutical industry are fast changing, because "many governments are trying to curb the use of low-tax jurisdictions in an effort to repair their damaged finances."[138] As such, the report foreshadows that companies based in high-tax jurisdictions will have lower returns on capital over the long term and will thus be at a significant competitive disadvantage, compared to those based in low-tax jurisdictions. Consequently, these companies will have to evaluate potential transfers to a more favorable regime.[139]

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[132] *Id.*
[133] PRICEWATERHOUSECOOPERS LLP, *Pharma 2020: Taxing times ahead Which path will you take?*, PHARMA AND LIFE SCIENCES (2010), at 11 *available at* http://www.pwc.com/en_GX/gx/pharma-life-sciences/pdf/ph2020_tax_times_final.pdf.
[134] *Id*., figure 6.
[135] *Id.*
[136] *Id. at 21.*
[137] *Id*.
[138] *Id*.
[139] *Id*.

The actions of the Government of Puerto Rico have had the effect of accelerating the omens warned in the industry reports. Desperate for revenues in the midst of a recession, the Government blitzed foreign pharmaceutical and manufacturing industries with a $6,000,000,000.00 tax. As stated by William Riefkohl, "this tax changes the basis on which the companies that were invited to invest in Puerto Rico made their commitment. For the first time, it sends the world a message that Puerto Rico can change its rules at any moment without previous prior notice."[140] Puerto Rico decided to explicitly exert its fiscal taxing autonomy to reach new taxpayers that, until this point, had not been reached by Puerto Rico's taxing arm. This was partly due to the practice of designing corporate structures, which would elude taxation in Puerto Rico. Through tax exemption grants, Puerto Rico specifically agreed to allow and enable the establishment of manufacturing in exchange for the economic activity these spurred. Now, Puerto Rico has explicitly circled around the conceded tax exemption grants and wielded its enormous fiscal taxing autonomy arm to stab at taxpayers and their income located in the United States and other foreign jurisdictions in order to reach taxpayers and their income that, up until then, were not thought to be located nor to have any direct presence in Puerto Rico. Additionally, to set up and defend the creditability of the modified effectively connected income and source rule and the related excise tax against United States income tax is to request a backdoor bailout for Puerto Rico from the United States Treasury Department. In essence, what has been done is to request that the United States Government assume at least a significant chunk of the bill.

Puerto Rico's economic feasibility requires swift, decisive steps towards promoting industrial, manufacturing, and knowledge-based economic activities. The Island is suffering the consequences of a lack of foresight and an inability to develop institutions that can drive its economy. The approval of Act 154 goes completely against the economic plan, as forged from the early 1950's, and which had the effect of raising the Puerto Rican economy up to its current state of development. Approving Act 154 to fund the related Individual and Corporate income tax reform is not sound fiscal policy; it's just shifting the responsibility from one side to another. Puerto Rico's economic recovery requires that politicians, private practitioners, and the men and women of industry focus on collaborative efforts that promote self-sustaining job creation and well-being, while ensuring fair tax rates for all stakeholders. In conclusion, it is tragic that Puerto Rico has used its current fiscal autonomy powers in a way that has affected the general welfare of its people and economy.

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[140] *Id.* (citing William Riefkohl, vice president of the Puerto Rico Manufacturers Association).

A CONSTITUTIONAL AND TECHNICAL ANALYSIS: THE IMPOSITION OF PUERTO RICO'S EXCISE TAX ON THE MANUFACTURING INDUSTRY

ANA DELIA MONTAÑEZ MORALES*

"No government can exist without taxation …
the grand art consists of levying so as not to oppress."
Frederick the Great
18th Century Prussian King

I. INTRODUCTION

A tax is a "compulsory monetary contribution to the state's revenue, assessed and imposed by a government on the activities, enjoyment, expenditure, income, occupation, privilege, property, etc., of individuals and organizations."[1] Taxes are used as tools for economic and social policies. Their main purposes are to generate income, encourage or discourage certain types of activities, redistribution of wealth, and economic control. An effective tax system must generate steady stream of government revenue, ensure fairness, be administratively feasible, and neutral.

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[1] Tax Definition, WebFinance, Inc., http://www.businessdictionary.com/definition/tax.html (last visited: Nov. 15, 2011).

The taxing power of Puerto Rico arises in Article 6, Section 2 of the Constitution.

> The power of the Commonwealth of Puerto Rico to impose and collect taxes and to authorize their imposition and collection by municipalities shall be exercised as determined by the Legislative Assembly and shall never be surrendered or suspended.[2]

The rule of taxation in Puerto Rico shall be uniform[3] and shall originate in the House of Representatives, but the Senate may propose or concur with amendments as on other bills. The taxing power of the Commonwealth of Puerto Rico is exercised through the Internal Revenue Code, which embodies domestic statutory tax law.

In fact, on October 25, 2010 the governor of Puerto Rico enacted Act No. 154[4], which amends several provisions of the Internal Revenue Code. The Act modifies the sourcing rules to treat certain nonresident alien individuals and foreign entities as engaged in a trade or business within Puerto Rico. It also sets forth a new excise tax on the acquisition of personal property manufactured in Puerto Rico and services related to the manufacturing of tangible property. In particular, throughout this paper I will examine the industry perspective towards the excise tax, evaluate its creditability as a foreign tax in other jurisdictions and analyze some constitutional aspects related to the imposition of the excise tax.

II. THE MANUFACTURING INDUSTRY IN PUERTO RICO

Since the 1950s, American pharmaceutical companies have invested heavily in Puerto Rico, encouraged by duty free access to the United States and tax incentives. As a result, the pharmaceutical industry has become one of the leading manufacturing industries in Puerto Rico. This industry has improved Puerto Rico's economy by helping to exponentially increase its exports and imports between fiscal years 1987 and 1997.[5]

The Commonwealth of Puerto Rico has a unique political and economic relationship with the United States which has allowed companies to manufacture products free from the Federal Income Tax imposed in the

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[2] P.R. CONST. Art. VI § 2.

[3] P.R. CONST. Art. VI § 3.

[4] Act to Amend Section 1123 and add a new Chapter 7 to Subtitle B – "Excise Tax", to Act No. 20 of 1994: Internal Revenue Code of Puerto Rico of 1994, Act No. 154 of October 25, 2010, P.R. LAWS ANN. tit. 13 § 8523, §§9085-89 (2010).

[5] WELCOME TO PUERTO RICO, Economy; http://www.topuertorico.org/economy.shtml (last visited: Nov. 15, 2011).

United States and, either, exempt from Puerto Rican income tax, or, subject to a reduced Puerto Rican income tax rate.[6] As such, the government of Puerto Rico has been actively campaigning to promote the island as a manufacturing destination.

The Puerto Rico Industrial Development Company ("PRIDCO") is the primary government agency charged with promoting Puerto Rico as an investment destination for companies and industries worldwide.[7] The following is the statement of invitation to companies to do business in Puerto Rico:

> Here you can enjoy the benefits and protection of operating within a U.S. jurisdiction with the added tax benefits of operating under a foreign tax structure. There are no federal income taxes and goods enter the U.S. market duty-free.
>
> In addition, Puerto Rico offers a highly attractive incentives package that includes maximum corporate income tax rates with a low percent, various tax exemptions and deductions, training reimbursement and special tax treatment for pioneer industries.
>
> Such a unique business proposition, coupled with a highly skilled workforce and flexible financing alternatives can only maximize your company's profitability.8

Many articles have been written to enhance the tax benefits offered by Puerto Rico to the manufacturing industry. For example, Fernando Goyco Covas expressed the following regarding the advantages of doing business in Puerto Rico:

> Given that essentially the entire spectrum of products may be manufactured, assembled or produced in Puerto Rico enjoying the Puerto Rican tax incentives, and products manufactured in Puerto Rico are not subject to US custom duties, companies organized outside of the US may obtain significant tax and US custom duties savings from manufacturing in Puerto Rico the products that they sell in the US market. . . .

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[6] Fernando Goyco Covas, How Puerto Rico is a Tax Haven for the US, INT'L TAX REV., available at http://www.internationaltaxreview.com/Article/2608678/How-Puerto-Rico-is-a-tax-haven-for-the-US.html

[7] PUERTO RICO INDUSTRIAL DEVELOPMENT COMPANY, Guide to Doing Business in Puerto Rico 71, available at http://www.pridco.com/pdf/aguidepr.pdf.

[8] PUERTO RICO INDUSTRIAL DEVELOPMENT COMPANY, Overview Incentives, available at http://www.pridco.com/index.php?option=com_content&task=view&id=37&Itemid=119.

> The distribution of products from Puerto Rico to the US, the Caribbean and Latin America could also be used to shift income from high-tax jurisdictions to Puerto Rico. If the distribution operations are conducted by a corporation organized outside of Puerto Rico, and the products are manufactured by the corporation or an affiliate outside of Puerto Rico, the foreign-source income derived from the sale of the products with title passing outside of Puerto Rico will not be effectively connected with the Puerto Rico trade or business of the corporation and, therefore, will be exempt from Puerto Rico income tax. [9]

III. PUERTO RICO TAX INCENTIVES

A company is considered resident of Puerto Rico if it is created or organized in Puerto Rico- also known as a domestic corporation- or if it is a foreign corporation engaged in a trade or business in Puerto Rico. A foreign corporation engaged in trade or business in Puerto Rico is subject to tax only on its Puerto Rico source income and income effectively connected with the conduct of the trade or business in Puerto Rico, and will be able to claim as deduction those expenses connected with or properly allocable to income that is effectively connected with its Puerto Rico business.[10]

Several laws have been passed to provide tax incentives through tax grants between the Government of Puerto Rico and eligible businesses. The latest act focused on tax incentives for the manufacturing industry is Act No. 73 of 2008, the Economic Incentives for the Development of Puerto Rico.[11] The tax benefits include a 90% exemption from property tax, a 60% exemption from municipal gross receipts tax, and reduced income tax rates on the income derived from the eligible activity. In addition, exemption is granted from excise taxes on raw materials, machinery and equipment used in the exempt manufacturing operations. However, on October 25, 2010, the Governor of Puerto Rico enacted Puerto Rico Act No. 154, hereinafter Act 154, which could potentially impact the landscape of the manufacturing industry of the island.

IV. PUERTO RICO ACT 154: OVERVIEW

"All was done in one weekend with no hearings, no input from anyone and no chance to submit any testimonials or comments", expressed

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[9] Goyco Covas, supra note 6.

[10] P.R. CODE REGS. ART. 1234-1(b)

[11] Puerto Rico Economic Development Incentives Act of 2008, Act No. 73 of July 2, 2010, P.R. LAWS ANN. tit. 13 §§ 8046, 8050, 8052, 8099 (2010).

William Riefkohl, Vice President of the Puerto Rico Manufacturers Association.[12] In fact, Act 154, formerly House Bill 2526, was filed on Friday, October 22nd by the Treasury Commission of the House of Representatives and was signed by the Governor on October 25th, establishing that the Act's main purpose is to finance upcoming tax reform legislation.

As explained on the previous section, the Puerto Rico tax system provides that sales by a non-Puerto Rico affiliate outside of Puerto Rico are not subject to tax in Puerto Rico to the extent that such entity is not engaged in business in Puerto Rico. However, Act 154 modifies the sourcing rules in order to treat certain nonresident alien individuals, and foreign entities as engaged in trade or business within Puerto Rico in order to subject them to Puerto Rico tax on certain transactions. Act 154 establishes specific rules with respect to sales made by a non- Puerto Rico entity of products manufactured by its Puerto Rico affiliate. It also sets forth a new excise tax on the acquisition of personal property and services to any non-Puerto Rico entity whose Puerto Rico affiliate has gross receipts from products manufactured or services rendered in Puerto Rico in excess of $75,000,000 for any of the three (3) preceding taxable years.

A. Approval of the Internal Revenue Code for a New Puerto Rico

The new Internal Revenue Code for Puerto Rico was signed into law on January 31, 2011, a and became known as the Internal Revenue Code for a New Puerto Rico (hereinafter the 2011 Internal Revenue Code for Puerto Rico Code). Specifically, section 1035.05 of the 2011 Internal Revenue Code for Puerto Rico Code sets forth that, for purposes of determining the income, gain or loss to be treated as effectively connected with the operation of a trade or business in Puerto Rico, the rules provided in subsection (f) and the definitions established in subsection (h) of Section 1123 of Act No. 120 of October 31, 1994, as amended, known as the "Puerto Rico Internal Revenue Code of 1994," in effect as of the date of enactment of this Code, shall apply. Furthermore, section 3070.01 of the 2011 Internal Revenue Code for Puerto Rico Code states that the provisions related with excise tax on the acquisition of personal property and services made after December 31, 2010 among related persons shall be provided in Sections 2101, 2102, 2103, 2104 and 2105 of Act No. 120 of October 31, 1994, as amended, effective on the date of enactment of the 2011 Internal Revenue Code for Puerto Rico Code.

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[12] Fernando Goyco Covas, Manufacturing Tax in Puerto Rico to Discourage US and EU Investments, INT'L TAX REV., Nov. 5, 2010, available at http://www.internationaltaxreview.com/Article/2712087/Manufacturing-tax-in-Puerto-Rico-to-discourage-US-and-EU-investments.html.

B. Effectively Connected Income Rules[13]

Act 154 expands the scope of the *office or fixed place of business* concept. It provides that the office or fixed place of business of a person in Puerto Rico will be considered as the office or fixed place of business of a foreign entity when the person in Puerto Rico: has authority to negotiate and conclude contracts on behalf of the foreign entity, provided it is not a general commission agent, broker, or other agent of independent status acting in the ordinary course of his business; or is a member of the same controlled group as the foreign entity, and for the taxable year or any of the three (3) preceding taxable years satisfies one of following thresholds:[14]

> If at least ten percent (10%) of the gross receipts of the person in Puerto Rico arise from the sale of personal property manufactured in Puerto Rico to, or from the performance of services in Puerto Rico for or on behalf of, the foreign entity.
>
> If the sales of personal property manufactured in Puerto Rico to, or the performance of services in Puerto Rico for or on behalf of, the foreign entity, account for at least ten percent (10%) of the cost of the total personal property or services purchased by the foreign entity.
>
> If the commissions or fees earned by the foreign entity from transactions related to personal property manufactured in Puerto Rico or services performed by the other person in Puerto Rico represent at least ten percent (10%) of the total commissions or fees earned from similar transactions.
>
> If the foreign entity facilitates the sale of personal property manufactured in Puerto Rico or the performance of services by the person in Puerto Rico, and such sales or services, when considered with the activities described above, account for at least:
>
> Ten percent (10%) of the total gross receipts of the person in Puerto Rico; or,
>
> Ten percent (10%) of the total gross receipts of the foreign entity from similar facilitation services.

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[13] See P.R. Internal Revenue Code § 1123(f).

[14] P.R. Internal Revenue Code § 1123(f)(4).

If the aforementioned thresholds are met, the foreign entity will be considered to be engaged in trade or business in Puerto Rico and, consequently, a portion of its income, gains, and profits will be treated as Puerto Rico source effectively connected income. The portion of Puerto Rico source effectively connected income will be determined based on a formula that considers four (4) factors: payroll, property, sales, and purchases. Accordingly, "the effect of the new source rule will be to treat income from the resale of purchases from Puerto Rico affiliates by a foreign entity, in part, as Puerto Rico source income effectively connected with the conduct of a Puerto Rico trade or business."[15]

C. Excise Tax

The new excise tax applies when gross receipts from the sale of personal property manufactured in Puerto Rico or services performed in connection with the manufacture of tangible property by the person in Puerto Rico exceed seventy-five million ($75,000,000) dollars for any of the three (3) preceding taxable years.

The terms personal property and service are defined as tangible property manufactured or produced in whole or in part in Puerto Rico, and services performed in Puerto Rico in connection with the manufacture or production of tangible property.[16]

The proposed regulations for Act 154 specify that a person is treated as having manufactured or produced tangible property in Puerto Rico if one or more of the following provisions apply:

> Employees or contractors substantially transform the property in Puerto Rico
>
> The assembly or conversion costs account for 20% or more of the total sale price.
>
> The product is produced or manufactured under industrial incentives legislation, including the Puerto Rico Economic Development Incentives Act of 2008 (Act 73), the Tax Incentives Act

[15] PricewaterhouseCoopers, Puerto Rico enacts new temporary excise tax on offshore manufacturers, permanent change in source-of-income rule, Pharma and life sciences tax news: Vol. 9, No. 13, available at http://www.pwc.com/gx/en/pharma-life-sciences/pdf/ptn_vol9-no13-final.pdf.

[16] P.R. Internal Revenue Code § 2101(b)(1).

> of 1998 (Act 135), the Tax Incentives Act of 1987 (Act 8), or the Industrial Incentives Act of 1978 (Act 26).[17]

The excise tax is temporarily implemented for six years, 2011 through 2016, at a rate of 4% but will phase out gradually at 1% for 2016. It will not be imposed upon net income, but on the value of the personal property and services acquired in Puerto Rico by the foreign entity after December 31, 2010. Such value will be determined according to the invoice rendered for such items. In absence of an invoice, the tax shall be based on the fair market value of the items.[18]

The excise tax shall apply only where the person acquiring personal property or services acquires such personal property or services directly or indirectly from another member of the same controlled group, or where a person provides distribution or facilitation services for or on behalf of another member of the same controlled group, including services on a commission or commissionaire basis, provides such services, that account during the three (3) preceding taxable years for at least:[19]

> 10% of the gross receipts of the Puerto Rico affiliate from the sale of personal property manufactured or produced, and services performed in Puerto Rico;
>
> At least 10%, by cost, of the total amount of personal property and services acquired by the affiliate subject to the excise tax;
>
> At least 10% of the total amount of commissions or other fees earned by such person; or in the case of transactions facilitated by the taxpayer, such transactions together with the activities previously mentioned account for at least 10% of the total gross receipts of the Puerto Rico affiliate or the total gross receipts of nonresident affiliate from facilitation services.

The Puerto Rico affiliate, the person receiving any consideration for personal property or services in a transaction, must collect the tax and deposit the aforesaid with the Secretary or any authorized financial institution on or before the fifteenth (15th) day of the following month.[20] Furthermore, such person must file quarterly returns with the Puerto Rico

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[17] See P.R. Internal Revenue Code Reg. 2101(a)-(1)(c) available at http://www.hacienda.gobierno.pr/pdf/reglamentos/7970.pdf.

[18] P.R. Internal Revenue Code § 2101(b)(2).

[19] P.R. Internal Revenue Code § 2101(c)(1).

[20] P.R. Internal Revenue Code § 2102.

Treasury Department.[21] Penalties will apply in case of non-compliance with the collection or timely deposit of the tax.[22]

Act 154 also provides for a tax credit mechanism.[23] A credit shall be granted for taxes paid by the nonresident affiliate to any of the states of the United States on the acquisition of personal property and service subject to the excise tax; and for excise tax imposed to another person that is a member of the controlled group on personal property and services that are subsequently acquired by the taxpayer. The amount of the credit shall be the lesser of the tax paid by the Puerto Rico affiliate to a state by reason of the imposition of a similar tax on the acquisition of the personal property and services, or the excise tax imposed by Act 154 with respect to such personal property and services.

V. MANUFACTURING INDUSTRY PERSPECTIVE

Many of the manufacturing plants operating in Puerto Rico were directly invited by the Government of Puerto Rico through the offer of significant tax incentives. Therefore, the enactment of an excise tax specifically applicable to the manufacturing industry, without the opportunity of public hearings, and effective almost immediately, was contradictory to the previous actions by the Government of Puerto Rico, and subsequently caused great uproar within the reaction of the manufacturing industry.

Government officials estimated that forty (40) through fifty (50) multinationals with operations in Puerto Rico will be subject to Act 154.[24] At the very least, 50% of the multinationals in Puerto Rico are in the pharmaceutical industry.[25] In fact, Pharmaceutical Research and Manufacturers of America (PhRMA) President John Castellani released the following statement about Act 154:

> PhRMA member companies have long had a strong presence in Puerto Rico, providing thousands of stable, high-paying jobs and investment in local economies in the search for new medicines.

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[21] P.R. Internal Revenue Code § 2103.

[22] Id.

[23] P.R. Internal Revenue Code § 2104.

[24] New tax in Puerto Rico to proceed despite extreme opposition, INT'L TAX REV.., Dec. 1, 2010, available at http://www.internationaltaxreview.com/Article/2730131/New-tax-in-Puerto-Rico-to-proceed-despite-extreme-opposition.html.

[25] Id.

> Law 154 will dramatically hinder these companies' positive efforts within Puerto Rico. The measure imposes special taxes on certain activities and transactions conducted by non-resident individuals and companies in Puerto Rico. This could significantly reduce the ability of PhRMA's members to operate in the Commonwealth and to continue to make significant investments in researching and developing innovative new medicines for patients. In addition, we are concerned that this significant new tax increase was developed and enacted without the opportunity for public input and comment. Transparent and predictable tax policies are critical to helping foster innovation in Puerto Rico. These policies should be developed and vetted through a public process involving all relevant stakeholders, including PhRMA member companies.[26]

In addition, the U.S. Chamber of Commerce established its 'strong opposition' to the Puerto Rico excise tax. "This new tax increase makes drastic changes to longstanding tax law, may have unintended consequences, and is potentially detrimental to new and existing foreign investment in Puerto Rico."[27] "By imposing a discriminatory new tax, without notice or the benefit of public hearings, a negative message is sent to new and existing investment in Puerto Rico. A strong incentive is created for foreign companies to look elsewhere for their manufacturing and distribution."[28]

Additionally, the National Association of Manufacturers (NAM) President and CEO John Engler also issued a statement related to Act 154:

> We are alarmed by the actions taken by the Puerto Rican government to impose a new excise tax on multinational manufacturers. Over the years, U.S.-based manufacturers have invested in Puerto Rico, most notably in the chemical, pharmaceutical and biotechnology industries. They represent approximately 80 percent of all the manufacturing jobs in Puerto Rico and nearly 26 percent of Puerto Rico's gross domestic product (GDP). The imposition of this tax could jeopardize the jobs of over 100,000 people and could damage business relationships that have

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[26] See Press Release, John Castellani, PhRMA Statement Regarding Puerto Rico Law 154 **(**Oct. 25, 2010), http://www.phrma.org/media/releases/phrma-statement-regarding-puerto-rico-law-154.

[27] Letter from R. Bruce Josten, Executive Vice President, Government Affairs of the U.S. Chamber of Commerce to Raúl Gayá Nigaglioni, Chairman of the Puerto Rico Chamber of Commerce, Letter opposing Puerto Rico's newly enacted 4 percent tax on foreign corporations (Oct. 26, 2010), available at http://www.uschamber.com/issues/letters/2010/letter-opposing-puerto-ricos-newly-enacted-4-percent-tax-foreign-corporations.

[28] Id.

> taken years to develop between the affected companies and the government of Puerto Rico.
>
> Even more concerning is that this law was passed in a period of 48 hours with no public hearings. By increasing costs for these manufacturers, the Puerto Rican government is jeopardizing jobs and economic growth at a time when our global economy is struggling to recover from a crippling recession.[29]

These declarations are, without a doubt, detrimental to the island's reputation as an investment destination. Companies seeking to invest capital diligently search for jurisdictions with political, economic and social stability. The companies affected by the excise tax were directly invited by the Government of Puerto Rico and the way that such an important act was enacted, without public hearings on a weekend, affects the stability perception and trust that these entities had in the jurisdiction. "Once a popular destination for multinationals, Puerto Rico's future as a favorable tax regime for foreign investment is now at stake."[30] Consequently, Puerto Rico's capability of attracting foreign investment has significantly declined. In order to ease the tension and improve its perception, the Government of Puerto Rico declared that the excise tax could be used as a Foreign Tax Credit for American companies.

VI. CREDITABILITY OF EXCISE TAX

> To mitigate or eliminate the risk of double taxation of the same income, Puerto Rico corporations have the option of either deducting or crediting the income and excess profit taxes paid or accrued during the taxable year to the United States, any possession of the United States, or any foreign country.[31]

First, it has to be determined whether a foreign tax imposed is a creditable tax. Section 901 of the US Internal Revenue Code ("US IRC") limits the credit to foreign taxes imposed on "income, war profits or excess profits." Section 903 of the US IRC provides that the term "income, war profits, and excess profits taxes"

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[29] Press Release, John Engler, National Association of Manufacturers (NAM) President and CEO,Manufacturers Oppose Puerto Rico's New Tax Increase on Multinational Companies (Oct. 27, 2010), http://www.nam.org/Communications/Articles/2010/10/Manufacturers-Oppose-Puerto-Rico.aspx.

[30] Goyco Covas, supra, note 12.

[31] P.R. Internal Revenue Code § 1023(c) and §1131(a)(1).

shall include a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country.

The regulations provide that in order for an in-lieu-of tax to qualify under Section 903:[32]

> the in-lieu-of tax need not be imposed because of administrative difficulty in determining the base of the generally imposed income tax;
>
> the base of the in-lieu-of tax need not bear any relation to realized net income; and
>
> the tax burden resulting from the in-lieu-of tax need not be the same as or less than the tax burden resulting under the generally imposed income tax.

The two basic requirements that must be satisfied in order for a foreign levy to be creditable under Section 903 are: (1) it must be a tax; and (2) it must meet the substitution requirement of the §903 regulations.[33]

"The term 'income, war profits, and excess profits taxes' shall include a tax paid in lieu of a tax on income, war profits, or excess profits otherwise *generally imposed* by any foreign country or by any possession of the United States."[34]

> The regulations do not contain any definition of 'generally imposed income tax'. It is clear, however, that the term has a narrower meaning than under earlier versions of the regulations. The regulations note, for example, that a tax on only one industry (banks) cannot be considered a generally imposed income tax. The regulations make it clear, however, that a tax imposed on all foreign residents doing business within a foreign jurisdiction is a generally imposed income tax, even if residents and locally owned enterprises are not taxed.[35]

The excise tax established in Act 154 is specifically imposed upon the manufacturing industry. In fact, it is established to forty or fifty multinationals, as estimated by government officials. As such, it cannot be

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[32] U.S. I.R.C. Regs. §1.903-1.

[33] Id.

[34] See I.R.C. § 903.

[35] See C. Dupy and K. Dolan, THE CREDITABILITY OF FOREIGN TAXES-GENERAL ISSUES, BNA TaxManagement Portfolio 901-2nd, p. A-29 (2005).

determined that it is classified as a 'generally imposed tax' since it is imposed to specific companies that are engaged in a specific industry. It is not a tax imposed on all foreign residents doing business in Puerto Rico. Accordingly, if it is not considered 'a generally imposed tax' it fails to meet the first requirement to be considered a creditable tax under section 903 of the U.S. Internal Revenue Code, and, consequently, should not be allowed to be taken as a foreign tax credit. Therefore, the analysis of the creditability could be ended here. However, I will proceed to analyze the second requirement.

The regulations provide that, in order for a tax to meet the substitution requirement, it has to operate as a tax imposed in substitution for, and not in addition to, a generally imposed income tax. The substitution requirement is not met if the foreign tax in question merely supplements an income tax without a reduction or exemption for those subject to the tax in question. In addition, the regulations require an exemption from the generally imposed income tax with respect to items subject to the substitute tax and not merely a reduction in the income tax.[36]

The excise tax is imposed to the affiliates acquiring personal property manufactured in whole or in part in Puerto Rico or services performed in Puerto Rico in connection with the manufacture or production of the tangible property. Such business entities were not subject to any tax before Act 154. The Act imposes the tax based on the value of the property or services; and after the temporary period of six years, it has been established that those companies will be subject to the new source rules that Act 154 added to the PR Internal Revenue Code. In fact, the proposed regulations establish that if the excise tax does not apply, then the Puerto Rico tax of the nonresident affiliated entity will be determined based on the sourcing rules.

However, since the excise tax is not considered an income tax, the tax will represent a 4% increase in cost of the products. Therefore, the resale of such products will create a multi-level of tax that will impact business entities without any contact with the Puerto Rico jurisdiction, and finally will have an effect on the individual consumers.

> The excise tax is technically imposed on each related purchaser of the personal property or services. Thus, it may impose multiple levels of tax on a series of sales between related parties. The law provides for a credit intended to prevent multiple layers of taxation. However, as currently drafted the law may not accomplish this goal in many cases.[37]

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[36] Id.

[37] Damon L. Lyon, David G. Noren, Lowell D. Yoder, Rachel E. Aaronson, Robert A. Clary II, Puerto Rico Enacts New Excise Tax that Impacts US Companies, LEXISNEXIS COMMUNITIES, TAX

Those taxpayers affected by the multiple level of tax will not necessarily be subject to the new effectively connected income source rules. As a result, the tax cannot be considered a substitution of an income tax.

Moreover, treasury regulations provide that, in order for a foreign tax to qualify as a creditable tax, the foreign levy must be a tax.[38] A foreign levy is actually a tax if it requires a compulsory payment pursuant to the authority of a foreign country to levy taxes, the payment must not be in exchange for a specific economic benefit, as defined by the Regulations, and the payment must not be refunded or credited. "An amount is not tax paid to a foreign country to the extent that it is reasonably certain that the amount will be refunded, credited, rebated, abated, or forgiven."[39] It is important to highlight that the proposed regulations allow for credits that could provide partial relief from the excise tax or even wipe out the tax in some cases. Credits that may offset the excise tax include:[40]

> General credit against tax: $4 million in 2011; after 2011, the excise tax rate is divided by 4% times $4 million. No unused credit may be carried forward or back or refunded.
>
> Alternative credit based on gross receipts: In lieu of the general credit, a controlled group may elect this credit if it meets certain conditions. The credit begins at $7 million in 2011 but reduces each year thereafter.
>
> Alternative credit where taxable acquisitions exceed certain thresholds: some controlled groups with taxable acquisitions of $4 billion or more that employ 500 employees or more with a payroll of $20 million may elect this credit. For 2011, the amount of the credit varies from $20 million to $80 million, based on the dollar amount of taxable acquisitions.
>
> Addition to alternative credit for incremental increase in employees: An additional credit may apply if the number employed by the controlled group in Puerto Rico exceeds 500 by at least 100. The credit ranges from $750,000 to $3.75 million, depending on the number employed. This credit applies for companies with taxable acquisitions in excess of $4 billion.

LAW COMMUNITY, PRACTITIONERS CORNER (Nov. 7, 2010, 01:58 PM), http://www.lexisnexis.com/Community/taxlaw/blogs/practitionerscorner/archive/2010/11/07/puerto-rico-enacts-new-excise-tax-that-impacts-u-s-companies.aspx.

[38] See U.S. Internal Revenue Code Regs. § 1.901-2.

[39] U.S. Internal Revenue Code Regs. § 1.901-2(e)(2)(i).

[40] PricewaterhouseCoopers, supra, note 15.

> Controlled groups with manufacturing and production facilities in multiple municipalities in Puerto Rico: A controlled group that has members engaged in manufacturing and production or manufacturing services in facilities located in three or more PR municipalities and employing more than 50 may be eligible for a credit of $3 million per municipality, up to a maximum of $15 million.
>
> Minority suppliers: A controlled group that makes direct purchases of goods or services from an approved minority business equal to or in excess of 75% of its total purchases of goods and services may be eligible for a credit based on how much these purchases exceed the average annual amount purchased from minority businesses during the preceding two years.
>
> Knowledge corridor and research and development investment credit: A controlled group may be eligible for a credit based on its contributions to the Puerto Rico Science, Technology and Research Trust or Special Economic Development Fund. A cap of either 1% or 2% of the excise tax would apply.[41]

Accordingly, these credits could have the effect of eliminating the tax in some circumstances. As a result, the excise tax will not be considered a 'tax' as defined by the regulations, since the credit may wipe out the levy. Consequently, if the foreign levy is not considered a tax, it fails to meet one of the requirements to be creditable as a foreign tax under the U.S. Internal Revenue Code. As such, for all the reasons explained above, it could be determined that the excise tax imposed by the Puerto Rico Act 154 is not creditable against U.S. taxes.

Furthermore, it is important to mention that on April 18, 2011, the IRS issued Notice 2011-29. The Notice provides that the determination of the creditability of the Excise Tax imposed by the Puerto Rico Act 154 requires the resolution of a number of legal and factual issues, and that pending the resolution of those issues, the IRS will not challenge a taxpayer's position that the Excise Tax is a tax in lieu of an income tax under section 903.

However, any non-US foreign business that purchases goods or services, as defined by Act 154, from a Puerto Rico affiliate could not take a foreign tax credit for the excise tax paid in Puerto Rico, as "tax credits do not apply to foreign sales, which account for a large proportion of what is manufactured in Puerto Rico."[42]

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[41] Id.

[42] Goyco Covas, supra, note 12.

VII. CONSTITUTIONAL ASPECTS OF EXCISE TAX

A. Export Taxes Prohibition

The Foraker Act, also known as the Organic Act of 1900, was enacted into law with the purpose of creating a civil government in Puerto Rico.[43] It also provided that the laws of the United States, that were not locally inapplicable, would be applicable to Puerto Rico. However, it expressly stated that the U.S. internal revenue laws were not applicable to Puerto Rico.[44] This section remained valid with the enactment of the Jones Act[45] and with the Federal Relations Act[46].

On March 24, 1927, Section 3 of the Jones Act was amended to include what has been known as the Butler's Amendment. Section 3 of the Jones Act expressly forbids export taxes; however, the Butler's Amendment conferred the power to the Government of Puerto Rico to impose taxes on imports provided that no discrimination shall be made between local products and foreign products.

> SEC. 3. That no export duties shall be levied or collected on exports from Porto Rico but taxes and assessments on property, income taxes, internal revenue, and license fees, and royalties for franchises, privileges, and concessions may be imposed for the purposes of the insular and municipal governments, respectively, as may be provided and defined by the Legislature of Porto Rico; and when necessary to anticipate taxes and revenues, bonds and other obligations may be issued by Porto Rico or any municipal government therein as may be provided by law, and to protect the public credit.
>
> *And it is further provided,* That the internal-revenue taxes levied by the Legislature of Porto Rico in pursuance of the authority granted by this Act on articles, goods, wares, or merchandise may be levied and collected as such legislature may direct, on the articles subject to said tax, as soon as the same are manufactured, sold, used, or brought into the island: *Provided,* that no discrimination be made between the articles imported from the United States or foreign

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[43] Foraker Act, ch. 191, 31 Stat. 77 (1900).

[44] Foraker Act, ch. 191, 31 Stat. 77, § 14 (1900).

[45] Jones Act – Puerto Rico Federal Relations Act, ch. 145, 39 Stat. 951 (1917).

[46] 48 U.S.C. § 734 (1955).

> countries and similar articles produced or manufactured in Porto Rico.[47]

Clearly, the excise tax imposed on the purchase of products manufactured in Puerto Rico by nonresident businesses can be denominated as an export duty. The tax is imposed according to value of the personal property and services acquired in Puerto Rico by the foreign entity. Therefore, there is discrimination between the local entity and the foreign entity. This discrimination was made on purpose since the local entity usually has a tax grant that provides several tax reliefs and exemptions. As a result, the government imposes the tax on the foreign affiliate that does not have an agreement with the government. In San Juan Trading v. Sancho[48], the Court established that the government may make *reasonable* classifications. It is arguable whether the excise tax imposed on the manufacturing industry, which specifically affects forty to fifty multinationals, is a reasonable classification. Butler's Amendment forbids the discrimination between local manufactured products and foreign products. However, the pertinent case law attacks taxes that discriminate in favor of local manufactured products, since in most cases the government imposes taxes to promote local products.

In this case, it can be argued that Act 154's excise tax discriminates against locally manufactured products. But still, it discriminates between local products and foreign products. Relevant case law has established that it can be discriminated when the local benefit is only incidental[49], since there are reasonable categories, when it is a hypothetical discrimination[50], and when it is expressly authorized by the U.S. Congress[51]. However, in this case we have an export duty, which is expressly forbidden, that discriminates between the Puerto Rico affiliates and the foreign entities without any reasonable classification.

B. Due Process and the Privileges and Immunities Clause

The taxing power of Puerto Rico arises in Article 6, Section 2 of the Constitution. However, this power is limited by the Butler's amendment, as explained above, and by the constitutional disposition of the due process clause.

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[47] Jones Act – Puerto Rico Federal Relations Act, ch. 145, 39 Stat. 951, § 3 (1917).

[48] San Juan Trading Co. v. Sancho, 114 F.2d. 969 (1st Cir. 1940).

[49] See U.S. Brewers Ass'n v. Srio. De Hacienda, 109 P.R. Dec. 456 (1980).

[50] See Texaco Puerto Rico v. Descartes, 304 F.2d. 184 (1st Cir. 1962).

[51] See Pan American Standard Brands v. United States, 177 F. Supp. 769 (1st Cir. 1959)

> No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.[52]

The Supreme Court of Puerto Rico established in International Harvester v. Srio. De Hacienda[53] the requirements to comply with the due process clause in the process of imposing any tax: there should be a nexus between the taxed activity and the state; and the taxable income must be reasonably linked to the activity that realizes the taxpayer in the state. There should be a reasonable nexus between the contribution to be paid and the benefits that are offered to taxpayers by the state.

The government of Puerto Rico has constantly promoted the island as an investment destination, and has even proposed organizational structures for the business entities to benefit from the tax incentives offered through tax grants. Puerto Rico has made direct invitations to manufacturing entities to create jobs in the island by manufacturing their products in Puerto Rico, and the government provides several tax incentives in exchange. The corporations that have accepted the invitation to produce in Puerto Rico have been organized in a way in which they can benefit from the tax incentives. As such, they have created a Puerto Rico Corporation to manufacture the products and several foreign affiliates to make business worldwide. It is clear that each affiliate is a separate taxpayer.

Act 154 imposes an excise tax to the purchaser of manufactured products in Puerto Rico through a Puerto Rico affiliate. The taxpayer is the purchaser not the manufacturer.[54] Therefore, the manufacturer has a nexus with the Puerto Rico jurisdiction, but the taxpayer -the purchaser- does not have any substantial nexus. The taxpayer does not have a reasonable nexus between the contribution to be paid and the benefits that are offered to taxpayers by the state, since all the benefits of the state are provided to the PR affiliate not the foreign affiliate. In addition, the taxpayers affected by this multi-level tax do not have any contact with the jurisdiction.

Furthermore, the Privileges and Immunities Clause has been expressly extended to Puerto Rico by the Congress[55]. In Postley v. Srio. De Hacienda[56] the Puerto Rico Supreme Court established that Puerto Rico cannot treat United States citizens as foreign taxpayers. This case discusses

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[52] U.S. CONST. amend. XIV, § 1.

[53] Int'l Harverster v. Srio. De Hacienda, 114 P.R. Dec. 281 (1983).

[54] P.R. Internal Revenue Code § 2101(a)(2).

[55] 48 U.S.C. § 737 (1950).

[56] Postley v. Srio. De Hacienda, 75 P.R. Dec. 874 (1954).

the constitutionality of a 29% tax imposed to citizens of the United States that are non-residents of Puerto Rico. The Supreme Court declared the tax unconstitutional because it was arbitrary. Similarly, the excise tax imposed by Act 154 treats U.S. affiliates as foreign affiliates. Consequently, after discussing the provisions and case law regarding the privileges and immunities clause, one cannot help but reach the conclusion that Act 154's excise tax should be declared unconstitutional.

C. Commerce Clause

In Sea Land Services, Inc. v. The Municipality of San Juan[57], the Federal District Court for the District of Puerto Rico held that the Dormant Commerce Clause is applicable to Puerto Rico. The reasons that led Congress to adopt a commerce clause also apply to Puerto Rico. Furthermore, the prohibition placed upon individuals to prevent the flow of interstate trade by imposing tax barriers is applicable to Puerto Rico. The Court expresses the following requirements for a tax to be in compliance with the Commerce Clause:

> The Commerce Clause "requires 'some definite link, some minimum connection between a state and the person, property or transaction it seeks to tax' "
>
> The tax must be allocated in a fair and equitable way
>
> The tax must not discriminate against the interstate commerce
>
> The tax must be related to significant services provided by the tax jurisdiction

In terms of the substantial link, the federal Supreme Court held in Quill Corp. v. North Dakota[58], that the test of nexus for the due process is different from the nexus required for the commerce clause. The former is related to the minimum contacts and reasonable notice, while the latter is related to the interstate commerce and the national economy. As such, the nexus under the commerce clause must be stronger than that for due process. The Court explained that a business must have physical presence in the jurisdiction in order for the state to impose a tax burden. Consequently, the excise tax imposed by Act 154 must be declared unconstitutional, since

[57] Sea-Land Services v. Municipality of San Juan, 505 F. Supp. 533 (D.P.R.1980).

[58] Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

the tax liability is imposed on foreign affiliates that do not have physical presence in Puerto Rico.

The 'nexus' is supplied if the corporation avails itself of the 'substantial privilege of carrying on business' within the State. The corporations that have physical presence in Puerto Rico are the Puerto Rico affiliates, a separate entity from the purchaser, and they are not considered the taxpayers. The Puerto Rico affiliates are the business entities that have the privilege of carrying business within the island. Another requirement is that the tax must be related to significant services provided by the tax jurisdiction. But, as explained, these taxpayers do not have any substantial nexus with the jurisdiction, and, therefore, do not receive any service from the jurisdiction. They receive the products from the manufacturer company in Puerto Rico, but do not receive any benefit or service from the state.

The other requirement is that the tax must be allocated in a fair and equitable way, and must not discriminate against the interstate commerce. The excise tax is imposed on the value of the product, and will be collected by the Puerto Rico affiliate. The fairness of the tax is questionable, since it is imposed to specific taxpayers (forty to fifty multinationals). The tax was effective almost immediately without the opportunity of any public hearing and any reasonable notice. The companies were unable to plan for the impact of the additional production costs, which included a substantial addition of 4%. The tax rates are phased down gradually, but the greatest impact of 4% was effective immediately. Additionally, the excise tax penalizes the purchase of products from Puerto Rico, which have a direct effect against the interstate commerce.

Therefore, the excise tax should be considered unconstitutional as it violates the commerce clause.

VIII. CONCLUSION

The Government of Puerto Rico has actively promoted the island as an investment destination for manufacturing plants. Puerto Rico offered tax incentives that functioned in such a way that, if the distribution operations were conducted by a corporation organized outside Puerto Rico and the products were manufactured and purchased by an affiliate outside Puerto Rico, the foreign-source income derived from the sale of products with title passing outside Puerto Rico would not be considered as effectively connected with the Puerto Rico trade or business of the corporation and, therefore, would be exempt from Puerto Rico income tax. Therefore, many companies utilized the jurisdiction as its main manufacturing plant for tax incentives in exchange of creating jobs. These corporations searched for a stable and trustworthy tax jurisdiction. However, Act 154 eliminated the benefits of such corporate structures and developed uncertainty and disappointment

within the manufacturing industry, which is the primary industry of our economy.

The Government of Puerto Rico, in order to control the expressions of the manufacturing industry, has emphasized that the excise tax applies to the foreign affiliates of the eligible business that have a tax grant with the government. However, it has been expressed that

> the grant of tax benefits to manufacturing and eligible services is statutorily characterized as a contract with the government of Puerto Rico in an effort to constitutionally shield the tax benefits from future legislation impairing such benefits before the holiday period expires.[59]

Therefore, Act 154 is a legislation that impairs the benefits of such companies, since it imposes an excise tax that increases production costs without adding value.

In addition, the government has declared that the excise tax should be creditable as a foreign tax credit in the United States. However, after analyzing the tax, it can be concluded that it does not meet the requirements to be creditable as a foreign tax under the U.S. Internal Revenue Code, since it is not a 'generally imposed tax' nor is it considered a tax as defined by the regulations, since the proposed credits could have the effect of completely eliminating it.

Furthermore, Act 154 expressly establishes that the taxpayer is the purchaser of the products manufactured in Puerto Rico, which creates a constitutional issue. For such reason, we analyzed the constitutional aspects under the Puerto Rico statutes and case law. First, under the Jones Act, the excise tax is considered unconstitutional since it is an export duty, which is expressly forbidden. Under the due process analysis, the excise tax is also unconstitutional, because the taxpayer does not have a reasonable nexus between the contribution to be paid and the benefits that are offered to taxpayers by the State. By analyzing the tax under the privileges and immunities clause, it must also be deemed unconstitutional seeing as it treats US business entities as foreign entities. Finally, under the commerce clause, it is also unconstitutional, because the excise is imposed on taxpayers that do not have physical presence in the jurisdiction and it penalizes the purchase of products from Puerto Rico.

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[59] Goyco Covas, supra note 6.

Consequently, the excise tax created by Act 154 is an unconstitutional tax that cannot be creditable as a foreign tax in other tax jurisdictions and one that has detrimentally impacted the manufacturing industry as well as Puerto Rico's economy.

A BASIC OUTLOOK ON HEDGE FUND STRUCTURE AND TAXATION ISSUES

GUILLERMO GIL DÍAZ*

ARTICLE

I. INTRODUCTION

In today's worldwide financial arena, investing in the global and state markets has become a sophisticated and difficult task. Financial instruments have been created to satisfy the market demands for risk taking and niche investing. One of the popular financial vehicles, which allow wealthy individuals, prospering businesses, and charitable organizations to participate in diverse investment strategies, are called hedge funds. "The term hedge fund is commonly used to describe a variety of different types of investment vehicles sharing common characteristics. Although it is not statutorily defined, the term encompasses any pooled investment vehicle that is privately organized, administered by professional money managers, and not widely available to the public."[1] Traditionally, these types of funds are highly leveraged and invest in high-risk financial derivatives. In today's global market, hedge funds encompass different types of strategies that may fit every client's individual investment need.

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[1] The President's Financial Working Group of Financial Markets, Hedge Funds, *Leverage, and the Lessons of Long Term Capital Management,* (Apr. 1999), at page 1 in Jerald David August & Lawrence Choen, *Hedge Funds--Structure, Regulation and Tax Implications*, 870 PLI/Tax 715 n. 7, (2009)(Emphasis added).

Given the nature of this type of investment vehicle, it is important that these funds are structured in accordance with applicable securities and tax law in order to avoid complex regulatory hurdles and minimize tax liability. This work will discuss the basic aspects of a Hedge Fund's structure and some of the fundamental issues they face in regards to United States Federal taxation.

II. HEDGE FUND STRUCTURE

A. U.S. Hedge Fund Corporate Structure

The basic hedge fund structure consist of two entities, (1) Hedge Fund, which possesses exclusively assets for the purpose of investing and (2) the Hedge Fund Manager, which administers the hedge fund's daily operation and investment strategy. The first important step in structuring a hedge fund is deciding under which type of legal entity the fund should be organized. There are five types of entities under which a fund may be structured: (1) Subchapter C corporation, (2) Subchapter S Corporation, (3) SEC Regulated Investment Company, (4) Partnership and (5) Limited Liability Corporation (LLC)[2]. Subchapter C corporations are usually not an appropriate legal entity to structure a hedge fund, mainly due to the high corporate tax rate and double taxation issues, as the shareholders' dividend distributions are also taxed. Although a Subchapter S corporation may elect to be a pass-through entity, the restriction on the number and type of investors is normally unsuitable for hedge funds[3]. Though regulated investment companies, consisting of mostly mutual funds, are not taxed at the entity level, they are subject to limitations on investment strategies and complicated regulations.[4]

Most hedge funds are organized as limited partnerships due to a partnership's ability to be considered a pass-through entity for tax purposes. Hence, partners are not subject to double taxation, and report their shares of the partnership's earnings on their individual tax returns. But if the partnership is

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[2] NAVENDU P. VASAVADA, TAXATION OF U.S. INVESTMENT PARTNERSHIPS AND HEDGE FUNDS ACCOUNTING POLICIES, TAX ALLOCATIONS, AND PERFORMANCE PRESENTATION 4 (2010).

[3] Subchapter S corporations must be a domestic corporation, only natural personas and certain trust and estates may be investors and has a limit of 100 shareholders. See Internal Revenue Service, S corporations, http://www.irs.gov/businesses/small/article/0,,id=98263,00.html (last visited Jan. 26, 2011).

[4] Anne Granfield, *Mutual Fund Tax Traps*. http://www.forbes.com/forbes/1998/0824/6204158a.html (last visited November, 20, 2011).

considered a publicly traded partnership, it would lose its pass-through status and be subject to taxation as a Subchapter C corporation for Federal income tax purposes[5]. Although an LLC may elect to be taxed as Subchapter C Corporations or pass-through entities, the entity may be subject to additional states taxes. Nevertheless, Hedge Fund Managers are typically established as a LLC or subchapter S corporation for liability reasons and normally elect to be taxed as a pass-through entity.[6]

After the Hedge Fund and Hedge Fund Manager have elected their respective type of business structure, the next step is filing for registration. Typically the hedge funds are organized in states such as Delaware because of their pro-business corporate laws and its state court's sophisticated history in corporate law jurisprudence.[7] The Hedge Fund Manager will be the general partner in the limited partnership or investment partnership (the hedge fund).[8] The organizations will be domiciled in Delaware, with its corresponding resident agent and physical address, but will not have a physical business in the state, since Delaware's law imposes state corporate taxes on LLCs and partnerships.[9] The principal place of business will be in a state like Connecticut, i.e. in a state that does not impose tax on LLC or pass-through entities and does not require the fund to register as an investment advisor in cases where the fund does not have to register with the Securities and Exchange Commission (SEC).[10]

A hedge fund's structure is designed to collect capital from numerous investors and pull it together to undertake a general or specific type of investment strategy. As established, the typical hedge fund structure is two entities, consisting of (1) the hedge fund manager, organized as an LLC, who will be the general partner in the hedge fund, and (2) the hedge fund as a limited partner.[11] The hedge fund manager administers the limited partnership's day-to-day operations and investments in exchange for management fees paid by the limited partners. The fees, voting power, power of attorney, designation of power, profit sharing and other issues are established in the partnership's agreement, the document which governs the terms of the partnership.[12] In the partnership agreement "investors must subscribe for a minimum dollar amount of limited partnership or limited

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[5] NAVENDU P. VASAVADA, *supra* note 2, at 5.
[6] *Id.* at 6.
[7] *Id.* at 7-9.
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] David August & Lawrence Cohen, *supra* note 1, at 724.

liability company interests (a substantial investment threshold is generally required to maintain the nonpublic and exclusive nature of the offering), subject to the discretion of the general partner to accept a lesser amount." [13]

According to "The Securities Act of 1933"[14] and "The Investment Company Act of 1940"[15], investment partnerships can only admit certain types of investors in order to be exempt from SEC regulations. A hedge fund does not want to trigger this type of complex and rigid regulation. The investors which do not trigger SEC regulations are the following: (1) Accredited investors, defined by the SEC in regulation D as individual with more than $1 million in assets, individuals with incomes exceeding $200,000 in the most recent two years or joint income of $300,000 for the same years, banks, insurance companies, pension funds, business and non profits exceeding $5 million in assets and executive officers or director of these companies;[16] (2) Qualified Purchasers- is an individual who owns not less than $5 million in investments or any entity that invest at least $25 million;[17] and (3) Foreign Investors.[18]

To accommodate the market's demand, many hedge funds will set up a feeder funds for its foreign and U.S. tax-exempt investors. A feeder fund is a fund established in a foreign jurisdiction, usually a tax haven, which has an interest in the investment partnership organized in the United States of America.[19] This fund may accommodate its foreign investors who do not want the IRS in their personal affairs. Usually the IRS requires the names of partners in a U.S. investment partnership, but regarding foreign feeder funds, the I.R.S only requires the foreign fund's name (and not the foreign investor's name).[20] This type of fund is also called a blocker corporation, which is of great significance to U.S. tax-exempt investor.[21] This issue shall be discussed later on the article.

B. Foreign or Offshore Hedge Fund Structure

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[13] *Id*.

[14] 15 U.S.C. §77(a) *et seq.*

[15] 15 U.S.C. §80(a)(1) et seq.

[16] 17 C.F.R. §230.501 *et seq; see also,* U.S. Securities and Exchange Commission, Accredited Investors, http://www.sec.gov/answers/accred.htm (last visited Jan. 27, 2011).

[17] NAVENDU P. VASAVADA, s*upra* note 2, at 11 citing U.S.D Chapter 2D, subchapter 1, § 80a-2(a)(51) (state qualified investors definition).

[18] *Id*. at 11.

[19] *Id.* at 40.

[20] *Id*. at 44.

[21] *Id.*

Establishing a foreign fund is fairly easy as there are many tax haven jurisdictions specializing in this type of organization. Although these jurisdictions are spread throughout the world, many of them are in the Caribbean. The most popular jurisdiction for hedge funds is the Cayman Islands.[22] This jurisdiction has no corporate tax and is governed by the laws of the United Kingdom, since the Cayman Islands is a British Overseas Territory.[23] To organize an offshore hedge fund, the same U.S. dual entity structure is used. Take the following example, where the hedge fund is to be registered in the Cayman Islands. Two organizations are registered: the hedge fund manager, registered as an exempt company and who is the general partner of the hedge fund, and the hedge fund, registered as a limited partnership or mutual fund. A partnership agreement is drafted in the same manner as in the U.S. and then it is submitted to the government for approval. Annual audit and registration fees are required for establishing the entities in the Cayman Islands, but their regulation is not as strictly enforced as those of the Securities and Exchange Commission.[24]

The master feeder structure is the way hedge funds with a diverse group of clients are commonly organized. This structure consists of several feeder funds and one master fund. The feeder funds, usually a limited partnership (but it may be an offshore corporation), will acquire an interest in the master funds.[25] Under this arrangement, the feeder funds will transfer all of its assets to the master fund. The master fund allocates all the feeder fund's assets and all of the trade transactions will take place in the master funds account.[26] This organization allows for the accommodation of different types of clients. For example, if the master fund is an offshore fund in the Cayman Islands, most likely there will be a feeder fund for U.S. investors and an offshore feeder fund organized as a corporation for U. S. tax-exempt organizations. Also, there might be another fund for foreign investors who wish to maintain a certain level of anonymity. All these investors buy an interest or a share in the feeder fund, which subsequently buys an interest in the master fund, allowing all the resources to be managed by the master fund. The location of the master funds will depend on the hedge fund's clients and hedge fund manager's tax strategy.

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[22] The City UK, Principal Market Series Hedge Funds May 2011, http://www.thecityuk.com/assets/Uploads/Hedge-funds-2011.pdf (last visited on November 20, 2011)

[23] Henry Smith, Cayman Island Exempted Limited Partnerships, 1683 PLI/Corp 63, 68.

[24] NAVENDU P. VASAVADA, *supra* note 2, at 38.

[25] *Id.* at 38.

[26] *Id.*

It is worth addressing that section 864(b)(2)(A)(1) of the U.S. Tax Code states that foreign entities' income derived from trading from their own account in stocks, securities and commodities are not engaged in trade or business in the United States.[27] These provisions enable foreign hedge funds to establish branches in the U.S. without fear of being taxed.[28] The guides clearly state that the fund may be a dealer of such financial instruments.[29] This provision is most useful to offshore hedge fund managers located in the U.S.

C. Passive Foreign Income Taxation

Another aspect worth mentioning is the U.S. tax treatment of foreign investment in passive income, as the majority of a hedge fund's income derives from passive investments. Section 871 states:

> Income other than capital gains.--Except as provided in subsection (h), there is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a nonresident alien individual as …. interest …, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income.[30]

This section of the code clearly states that a 30% withholding tax will be imposed on all U.S. passive income received by foreign individuals. Section 881 is the equivalent statute for foreign corporations. Capital gains have been excluded from the withholding tax due to the buyer's uncertainty and lack of knowledge about the seller's tax base.[31] Also, section 871(h) and 881(c) exempts from taxation portfolio interests[32], resulting in almost all U.S. interest received by an offshore hedge fund being tax free. An exception to section 871(h) and 881(c) has been provided to any foreign person who owns 10% or more of the shares of the

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[27] I.R.S., Trading Safe Harbors, http://www.irs.gov/pub/irs-regs/10603198.pdf (last visited Dec. 22, 2010).

[28] *Id.*

[29] *Id*. See also, NAVENDU P. VASAVADA, *supra* note 2, at 42.

[30] I.R.C § 871(a)(1) (2011).

[31] JOSEPH ISENBERGH, INTERNATIONAL TAXATION 84 (3rd ed., 2010).

[32] U.S. source interest from debt obligations held for investment by a foreign person.

debtor.[33] For example, if X, a foreign person, own 15% of the share of Z, a U.S. corporation, and X buys bonds issued by Z, the interest from X's investment Z's bonds will not be tax free.

Vasavada explains that the withholding of the 30% tax on passive income to foreign investors may become a structural matter that the offshore hedge funds must deal with. If the master fund is in the U.S and it admits offshore investors, then the master fund will be the withholding agent. If the master fund is the offshore hedge fund and it wants to make sure that their U.S. investors are not subject to an inapplicable tax, they must file the required 1042 withholding tax form. This form requires the names of all investors in the fund, and may also require the fund to set up a separate feeder fund for its non-U.S. investors to ensure that the only name the IRS receives is the name of the non-U.S. feeder fund. U.S. Tax-Exempt Corporations that invests in foreign feeder funds organized as corporations will have the 30% flat rate tax, since it applies to the foreign corporation. Hedge Funds managers must take this fact into consideration when designing the particular investment strategy in order to minimize as much as possible the potential tax liability to their investors. [34]

III. US INVESTORS IN OFFSHORE HEDGE FUNDS

When offshore hedge funds take U.S. investors as limited partners, they are exposed to unpopular and uncertain dispositions of the United Sates Tax Code which make it difficult for the fund managers to take on too many U.S. investors. Primarily, two portions of US tax code affect the relationship between offshore hedge funds and U.S. investors: Controlled Foreign Corporations and Passive Foreign Investment Companies.

Section 957(a) defines "Controlled Foreign Corporations" (CFC) as "any foreign corporation if more than 50 percent of (1) the voting power of all class of stock…entitled to vote, or (2) the total value of the stock is owed… by United States shareholders on any day during the taxable year of such foreign corporation."[35] To understand this definition it's very important to also state the a U.S Share holder is defined in section 951(b) as "a United States person… who owns… 10 percent or

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[33] *Id*. at 86.

[34] NAVENDU P. VASAVADA, *supra* note 2, at 46.

[35] JOSEPH ISENBERGH, *supra* note 31, at 191.

more of the total combined voting power of all class of stock entailed to vote of such foreign corporation."[36]

Under I.R.C. Subpart F rules, any income derived from a CFC which is considered to be tax haven income[37] will be subject to taxation in the United States. The most significant tax haven income is the Foreign Base Company Income which, according to the U.S. tax code, is divided into the following four types of foreign income: (1) Foreign personal holding company income, (2) Foreign base company sale income, (3) Foreign base company service income, and (4) Foreign based company oil related income.[38] Given the scope of this work, it is only necessary to discuss one of the four types of income: Foreign personal holding company income. Foreign personal holding company income is mostly gross income derived from passive investments such as dividends, interest, sale of property, rent, royalties and annuities.[39] Although an exception exists for active financial service income, it does not apply in the case of hedge funds since most of the investment partner's income is derived from passive investment, even though it is actively managed. This exclusion refers to more traditional banking services, such as loan origination.

In the offshore hedge fund industry, it is unlikely that rules regarding CFCs apply to participation interest in a limited partnerships or non-voting shareholders in offshore legal entities.[40] However, since the U.S. government has been historically known to stretch its outbound power of taxation, it may not be long before new legislation is approved which imposes taxes on interest holdings in any foreign entity. It is therefore important for hedge fund managers and investors to take into consideration these rules and try to stay clear of any situation that would trigger CFC rules.

Another problem that the U.S Internal Revenue Code presents to U.S. investors in a foreign hedge fund is the effects of being classified as a Passive Foreign Investment Company (PFIC). According to section 1297(a) of the Internal Revenue Code a Passive Foreign Investment Company is defined as

> Any foreign corporation if (1) 75 percent or more of the gross income of such corporation for the taxable year is passive income, or (2) the average percent of assets….held by such corporation during

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[36] I.R.C § 957(a) (2011). *See also* JOSEPH ISENBERGH, *supra* note 31, at 191.

[37] Income which is shifted from a high tax jurisdiction to low tax jurisdictions.

[38] I.R.C § 957(a)(1) (2011). *See also* JOSEPH ISENBERGH, *supra* note 31, at 191.

[39] *Id.*

[40] NAVENDU P. VASAVADA, *supra* note 2, at 18.

> the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent.[41]

Therefore, any foreign entity that engages primarily in the business of investing and trading in securities will be considered a PFIC.[42] Offshore hedge funds, for the most part, will be considered subject to the PFIC regimen for its U.S investors' tax purpose[43]

The current statue that governs PFIC's imposes a distinctive type of taxation which focuses on denying the U.S. investor the benefit of deferring taxation on their PFIC investment. Section 1291 establishes that at the moment of distribution or sale of a PFIC holding, a special procedure is used to calculate the tax liability of the aforementioned investment. The income from the distribution or sale is proportionally allocated to each number of years the U.S. investors held the PFIC's stock or investment. Afterwards, the current year amount is included as ordinary income and the taxpayer must pay a deferred tax amount that represents the tax owed from the prior years plus interest.[44]

U.S. PFIC investors can also benefit from an alternative "check the box" provision, allowing U.S. Investors to select taxing their PFIC holding under a current U.S. taxation regimen.[45] This option taxes the PFIC income in a manner much like CFCs. A third option for taxing PFIC, established by section 1296, involves a mark to market valuation of the PFIC shares, or holdings, and recognizing the unrealized gain or loss each taxable year. By means of this option, the U.S. investor includes as ordinary income any unrealized gains over the taxable year or deducts an ordinary loss for any unrealized loss during the taxable year.[46] Following this method, the tax basis for the PFIC will be up-to-date if the shares are sold during future years and there is no deferred tax to be applied. The only problem with this election is that it is only available to PFIC that trade in a regulated market or periodically reports its net assets value.[47]

Due to the compliance requirements that U.S investors trigger for offshore hedge funds, many have decided not to include U.S. investors. Since many offshore entities qualify as PFIC's, the IRS may require them to calculate the PFIC income for their U.S investors and many hedge fund managers view all the additional filing

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[41] I.R.C. § 1297(a)(2011). See also, JOSEPH ISENBERGH, supra note 31, at 204.

[42] *Id.*

[43] NAVENDU P. VASAVADA, *supra* note 2, at 18.

[44] I.R.C §1291 (c)(2)(2011). See also, JOSEPH ISENBERGH, supra note 31, at 204.

[45] JOSEPH ISENBERGH, supra note 31, at 204.

[46] *Id.*

[47] *Id.*

requirements as a hazard rather than an investment, and thus shut the door to U.S investors.[48]

The U.S. Tax Code enables master feeder structured foreign hedge funds to be classified as a partnership or association for U.S. tax purposes and not be classified as a PFIC[49]. Hence, "if a U.S. Investor in an offshore fund selects the check the box provision of its classification [it] is not subject to PFIC rules."[50] Many hedge funds that use the master feeder structure can see significant gain from acquiring the IRS status as a partnership. Offshore master funds tend to set up feeder funds just for United States investors. This feeder fund, which owns a stake of the master funds, handles all the IRS filing and requirements for the U.S. Investors.[51] Accordingly, the U.S. investors do not have to worry of the difficulties and complexities of the PFIC classification.

Foreign hedge funds dealing with U.S. investors seem to cause a lot of regulatory complexity, but considering the benefits received by the hedge fund managers, it is well worth it. It may seem easier to just place the master fund in the United States, but this is dependent upon each particular hedge fund and its client base.[52] For example, large institutions and wealthy clients are still concerned with offshore hedge funds due to the lack of regulation and the legal remedies available in other countries, many of which are unknown jurisdictions and do not have extensive and/or sophisticated financial traditions.[53] Therefore, there is still a stigma attached to investing in offshore hedge funds, especially in those which are established in small countries considered tax havens.

IV. TAX EXEMPT ORGANIZATIONS

Tax-exempt organizations are granted their status based on public interest. Section 501(c)(3) of the Internal Revenue Code establishes that:

> An organization must be organized and operated exclusively for exempt purposes set forth in section 501(c)(3), and none of its earnings may inure to any private shareholder or individual. In addition, it may not be an action organization, i.e., it may not

[48] NAVENDU P. VASAVADA, *supra* note 2, at 40-41,
[49] I.R.C §301 (2011). NAVENDU P. VASAVADA, *supra* note 2, at 18, note 14.
[50] NAVENDU P. VASAVADA, *supra* note 2, at 15.
[51] *Id*. at 44.
[52] *Id*. at 43.
[53] *Id*. at 35-36.

> attempt to influence legislation as a substantial part of its activities and it may not participate in any campaign activity for or against political candidates.[54]

The government considers that granting a tax-exempt regime to charitable organizations such as universities, research foundations and pension funds will ultimately benefit the general population. Tax-Exempt Organizations represent a vast part of the U.S. economy and are of great importance to financial markets and institutions. Hedge funds derive a large portion of their investment from university endowments and pension funds.

> "A 2006 study of national endowments conducted by the National Association of College and University Business Officers (NACUBO) reveals that, of the 755 endowments included in the survey, those with greater than $1 billion in investment pool assets had an average of 22.4% of those assets invested in hedge funds."[55]

The difficulty with U. S. tax-exempt organizations investing in hedge funds is that U.S. hedge funds are mostly organized as limited partnerships, because of the benefit of reducing or eliminating double taxation to its U.S. investors. The main problem arises from the use of debt by tax-exempt organizations. Since most hedge funds strategies rely heavily on leverage and a limited partnership being a pass-through entity, the investment partnership (hedge fund) use of debt may trigger "Unrelated Business Taxable Income" for tax-exempt organizations. "Unrelated Business Taxable Income" (UBTI) is defined as "the gross income derived from any unrelated trade or business, regularly carried on by the exempt organization, less the deductions directly

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[54] I.R.S., Exemption Requirements - Section 501(c)(3) Organizations, http://www.irs.gov/charities/charitable/article/0,,id=96099,00.html (last viewed Jan 15. 2011).

[55] Nat'l Assoc. of Coll. & Bus. Officers, 2006 NACUBO Endowment Study, Average Asset Class allocation of Total Assets Table (2007) [hereinafter NACUBO Study], available at http://www.nacubo.org/documents/research/2006NES_ Allocation.pdf., as cited in Summer A. LePree, *Taxation of United States Tax-exempt Entities' Offshore Hedge Fund Investments: Application of the Section 514 Debt-financed Rules to Leveraged Hedge Funds and Derivatives and the Case for Equalization*, 61 TAXL 807, at pages 810-11 (2008).

connected with carrying on the trade or business."[56] UBIT has exceptions which include passive income from: rent of real property[57], mixed leases[58], dividends, interest, royalties, income from lending securities, gain or loss from the disposition of property, income from research grants, income from federal authorized licenses, and membership in mutual or cooperative electric companies.[59]

In the past, tax-exempt organizations were not taxed on any income, including the income derived from a Feeder Corporation that owned an unrelated business, as long as it was all distributed to the tax-exempt entity. This situation angered many Americans since many of these tax-exempt organizations were competing with fully taxable business. Congress in 1950 enacted the UBIT rules, limiting the number of business activities a tax-exempt organization could undertake.[60] After this enactment, a number of financial transactions emerged to reduce tax liability by sale-lease back agreements. Another mechanism that may be used to limit the UBIT liability was the transferring or sale of the assets of an unrelated business subsidiary to the holding tax-exempt organization and the holding organization's lease of the assets back to the subsidiary. This created passive income for the tax-exempt organization and increased the operating expenses of the subsidiary, limiting its UBIT tax exposure.[61] Due to all these creative legal transactions and pertinent jurisprudence validating these transactions, Congress enacted the "Tax Reform Act of 1969" that includes all debt-financed income from property not related to the organizations trade or business as UBIT.

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[56] I.R.S., Publication 598, *Tax on Unrelated Business Income from Exempt Organizations*, http://www.irs.gov/pub/irs-pdf/p598.pdf (last viewed Jan 22, 2011)

[57] This rent only includes fixed rent and rent from a fixed percentage of gross receipts or sales. *See Id.*

[58] Mixed leases are completely only excludable from UBIT if only 10 percent or less of the rent is from personal property. If personal property accounts for 10-50 percent of the rent only the part of the rent is derived from the real property is excludable from UBIT calculations. Finally, if more than 50 percent of the rent is derived from personal property none of the income is excludable from UBIT calculations. *See Id.*

[59] I.R.S., Publication 598, supra note 23.

[60] I.R.C. § 513, cited in La. Credit Union League v. United States, 693 F.2d 525, 540 (5th Cir. 1982). *See also*, Summer A. LePree, *supra* note 52, at 819.

[61] Summer A. LePree, *supra* note 22, at 819-20.

The problems related to tax-exempt organizations and hedge funds have been easily solved by having hedge funds invest in blocker corporations.[62] Structuring a blocker corporation for a master feeder structured hedge fund is fairly simple. The fund would have to organize a separate offshore feeder fund as a corporation, which in part has an interest in the master fund's limited partnership. The income that is generated by the limited partnership (master fund) is pass-through to the corporation, which then distributes the income as a dividend to the tax-exempt organization, without activating any UBIT rules. It is important that this offshore feeder fund be located in a tax haven jurisdiction. It would be pointless to establish the offshore feeder in a high tax jurisdiction like the U.S., due to the high corporate tax that would have to be paid on the earnings distributed from the master fund to the corporation. When this structure is established correctly, no significant tax emerges on the tax-exempt organization's investment. This offshore blocker structure has been authorized by the IRS in private letter rulings 20025116 to 20025118, which have served as the basis for all of the offshore tax-exempt organizations investing in hedge funds.[63]

In I.R.S. Private Letter Ruling 200251016[64], the ruling was requested by a Charitable Remainder Units Trust, who held interest in a limited partnership M. In the ruling, they requested authorization to form a Foreign Corporation N, which would be owned by limited partnership M. Corporation N would then make contributions to other limited partnerships and corporations (investment funds), financed by debt[65] . The IRS stated that:

> [u]nder sections 512(c), 512(b)(4), and 514, income from N would be UBTI to M if received directly by M because it is debt-financed income. However, here the income will arrive at M indirectly through N, which will pay dividends to M. Dividend income is not taxable under section 512(b)(1) of the Code or subject to the "controlled organization" rules of section 512(b)(13). Further, M has not itself incurred debt in financing its interest in N, and thus such

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[62] *Id*. at 840.

[63] *Id*.

[64] I.R.S. Priv. Ltr. Rul. 02-51-016, (2002) 2002 WL 31846286. *See* Summer A.Lepree, *supra* note 55, at 840.

[65] *Id*.

> dividend income is not debt-financed income described in section 514."[66]

This ruling has resulted in tax-exempt organizations becoming one of the largest client groups in the foreign hedge fund market. These type of rulings have given large tax-exempt institutions like universities and pension funds, a certain peace of mind when it come to taxation issues regarding UBIT and foreign hedge funds. [67] However, they still face concerning issues in regards to the legal environment and lack of regulations under which non-U.S. jurisdiction based hedge funds operate.

It is beneficial to state that not all hedge fund strategies trigger UBIT rules for tax-exempt institutions; only when a hedge fund borrows money to acquire a security investment will it trigger UBIT rules, if a tax-exempt organization has a direct interest in the partnership.[68] Most investment strategies such as shorting, investing in options, future contracts and notions contracts will not be considered to set off UBIT rules.[69]

V. HEDGE FUND MANAGER'S COMPENSATION AND CARRIED INTEREST

Hedge Fund managers are compensated by means of management fees (fixed fees) and performance fees. Management fees are normally established at a rate of 2 percent per annum[70] of the fund's net assets value[71]; moreover, this type of fixed fee is the amount charged by the hedge fund manager to cover the basic expenses of running the fund. Fixed fees are taxed at ordinary income tax rates. On the other hand, performance fees are tied to a percentage rate of the funds net realized and unrealized profits after fixed fees[72], usually at 20 percent.[73] However,

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[66] I.R.S. Priv. Ltr. Rul., *supra* note 60.

[67] *See* Summer A.Lepree, *supra* note 55, at 819.

[68] I.R.C. § 514.

[69] *Id*. at 853.

[70] *Tax Report*, The Wall Street Journal, http://online.wsj.com/article/SB10001424053111903885604576486541761322496.html, last visited November 20, 2011)

[71] Net asset value = funds assets-funds liability.

[72] NAVENDU P. VASAVADA, *supra* note 2, at 46-77.

[73] Tax Report, supra, note 68.

these profits are subject to certain restrictions, such as watermark[74] and hurdle rate[75]. For example, a partnership/management agreement may establish that performance fees shall only be paid from the fund's profits in excess of the one year Treasury bill rate.

Performance fees are usually collected in the form of carried interest. Carried interest can be defined as an income derived from an interest in a partnership, that returns a disproportionate amount of income relative to the capital invested to acquire the interest. [76] The carried interest in performance fees is subject to preferential rates due to the legal and economic characteristics of said compensation. Given the high amount of performance fees hedge fund managers receive, manager compensation has been a problem of much debate for years and has recently been a topic of scrutiny and intense discussion. Many believe that such a high amount of wealth should be taxed as ordinary income and not as capital gains.[77] However, not all hedge fund managers receive enormous performance fees, but those managers who outperformed the market will most likely receive very preferable and accommodating performance compensation, made up mostly of carried interest.

Carried Interest, as previously defined, is income derived from an interest in a partnership which returns a disproportionate amount of income relative to the capital invested to acquire the interest. Most of the income is subject to long-term capital gains rates, since the tax treatment for partnerships establishes that the partner must pay taxes on income as it is characterized at the partnership level. Furthermore, the long-term capital gains tax rate is significantly lower than the ordinary income tax rates. [78]

The debate on the tax treatment of carried interest has its roots in profits interest that is rendered as a compensation for a service performed to a partnership. Thus, it is necessary to establish the difference between carried interest and profit interest. Profit interest, by definition, "interest in respect of

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[74] Watermarks are a provision to performance fee calculation that establishes that performance fee can only be paid if the funds profits surpass the funds highest net asset value. Usually this changes with each investor depending on the net asset value of the date of admission to the fund. *See* NAVENDU P. VASAVADA, *supra* note 2, at 46-77.

[75] Hurdle rate are economic benchmark that the fund manager must surpass to be able to collect performance fees. Commonly, hurdle rates are express as Libor + or minus, or t-bills rates. *See* NAVENDU P. VASAVADA, *supra* note 2, at 46-77.

[76] Matthew A. Melone, *Success Breeds Discontent: Reforming the Taxation of Carried Interest - Forcing a Square Peg into a Round Hole*, 46 DUQLR 421 (2008), at 423.

[77] Tax Report, *supra* note 68.

[78] *Id*.

which the manager has paid nothing and would get nothing if the entity were liquidated immediately after the interest was issued."[79] Therefore, the main difference between a profit interest and a carried interest is that the latter takes into consideration that some capital was invested and if the partnership is liquidated, there would be a justifiable claim to some of the proceeds. Carman argues that:

> [T]he general practice has developed to view the disproportionate allocation that is part of the carried interest as a separate profits interest subject to the two revenue procedures. Although no formal statement has been made on the issue, representatives of the IRS have informally indicated that they would not challenge such a position if the disproportionate rights of the carried interest were separately transferable.[80]

It is essential to discuss that partnership tax law differentiates the services rendered for a capital interest in a partnership and a profit interest. Section 83 states that a person who receives compensation for services provided in the form of a capital interest in a partnership are considered to have received income.[81] The recognition of income occurs when the capital interest is transferable or not subject to a substantial risk of forfeiture, in other words, when the capital interest becomes vested[82], and thus the amount or the recognition of such depends on the application of section 83.

> "The value of an interest in such partnership capital so transferred to a partner as compensation for services constitutes income to the partner under section 61. The receipt of a capital interest in a partnership in exchange for services is taxable to the recipient. The amount of such income is the fair market value of the interest in capital so transferred".[83]

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[79] Paul Carman, *Taxation of Carried Interest*, 865 PLI/Tax 27, 31 (2009).
[80] *Id*.
[81] I.R.C. § 83 (2011).
[82] ALAN GUNN & JAMES R. REPETTI , PARTNERSHIP INCOME TAXATION 26-27 (4th ed., 2005); See also Treas. Reg. § 1.721-1(b)(1).
[83] Treas. Reg. § 1.721-1(b)(1) (as amended 1996), *See* Melone, supra note 76, at 448.

As mentioned before, under section 83, in properties which are issued as compensation for services, the excess of the value over the amount paid will be considered gross income for the taxable period in which the property is transferred or has substantially vested. Section 83(b) establishes that a taxpayer may elect to include the income related to the property in the first taxable year the property was issued but not fully vested.[84]

The notion that issuance of profit interest as compensation is not a taxable event was first established in Hale v. Commissioner,[85] and the language in section 721-1(b)(1). Later, in Diamond v. Commissioner[86], a service provider was issued a 60 percent profit interest in a real estate deal for helping the partnership secure the financing for the project. Shortly after the issuance of the profit interest, Mr. Diamond sold his profit interest for $40,000. The court held that Mr. Diamond recognized $40,000 income when he received the profit interest as compensation. Consequently, the court established that profit interests are a taxable event upon receipt. However, it has been argued that the profit interest established in Diamond may have been a capital interest. Gunn's rationale is that since the interest in the partnership was tied to the sale of a building, the partnership's only asset, the issuance of the profit interest gave Diamond some notion of capital in the partnership.[87]

Following the great upset represented by Diamond, Campbell v. Commissioner[88], gave hope to tax lawyers around the country. The court held that a profit interest in a tax-shelter partnership was not taxable upon receipt because of its lack of fair market value. Although this opinion did not overturn Diamond, it opened a gate for service providers to defer tax on profit interests.[89] Due to the amount of resources and time invested in the litigation of this tax issue, the government saw fit to release a set of

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[84] I.R.C. § 83(b) the rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by any individual, *See* Cartman, *supra* note 79, at 31 n. 15.

[85] Hale v. Commissioner, 24 T.C.M. 1497, 1502 n. 3 (1965)

[86] Diamond v. Commissioner, 492 F.2d 286 (7th Cir. 1974).

[87] ALAN GUNN & JAMES R. REPETTI, *supra* note 82, at page 30, note 21 (discusses outcome of Diamond v. Commissioner).

[88] Campbell v. Commissioner, 943 F.2d 815 (8th Cir. 1991).

[89] Rev. Proc. 2001-43, 2001-2 C.B. 191 (2001), see also ALAN GUNN & JAMES R. REPETTI, *supra* note 82, at 34.

guidelines for taxpayers dealing with this issue. Rev. Proc. 93-27 defines a capital interest as an interest in a partnership that would yield proceeds if all the assets were sold and the partnership liquidated.[90] Also, it defines profit interest as interest in a partnership that is not a capital interest. Furthermore, Rev. Proc. 93-27 establishes that profit interests issued to service providers are not a taxable event. This rule does not apply if (1) the profits interest is an interest in a substantially certain and predictable stream of income from partnership assets such as high quality debt securities or a high quality net lease, (2) the partner disposes of the profits interest within two years of the grant, or (3) the profits interest is a limited partnership interest in a publicly traded partnership.[91] Rev. Proc. 2001-43 sheds light on the fact that the determination of whether an interest is a profit interest can be made the moment the profit interest is granted and that neither the issuance of a profit interest nor the vesting of that interest shall be considered a taxable event.[92]

I.R.C. § 409A, created by "The American Jobs Creation Act of 2004"[93], establishes a set of rules which a deferred compensation taxpayer must follow, or consequently risk a 20 percent penalty plus interest on any current or past deferred compensation. Under the scope of this legislation, deferred compensation plans which meet the requirements must:

> (1) not permit early distribution. Pursuant to this requirement, a plan may permit distribution only upon separation from service, disability, death, unforeseeable emergencies, change in control of the service recipient, or pursuant to a fixed schedule;[94] (2) the plan may not permit the acceleration of benefits, except as a result of separation of service, death, disability, change in control, or unforeseeable emergencies;[95] and (3) deferral elections must be made within prescribed

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[90] Rev. Proc. 93-27, 1993-2 C.B. 343 (1993)

[91] Paul Cartman, *supra* note 79, at 37.

[92] *Id*.

[93] American Jobs Creation Act of 2004, Pub. L. No. 108-357 (Oct. 22, 2004).

[94] I.R.C. § 409A(a)(2)(A) (2006), as cited in Melone, supra note 76, at 436, note 71.

[95] I.R.C. § 409A(a)(3); Treas. Reg. § 1.409A-3 (2007) as cited in Melone, supra note 76, at 436, note 72.

> time limits, generally by the end of the service provider's tax year immediately preceding the deferral year.[96]

Nevertheless, the I.R.S. has not expressed whether this statue is applicable to partners and partnerships. Accordingly, income from profit interest in a partnership shall not considered deferred compensation pursuant to the 409A legislation,[97] unless the I.R.S. releases specific guidelines that enable its applicability to partners and partnerships.

In accordance with tax laws and regulations, hedge fund carried interest is not a taxable event at the time it is granted. But, it is important to clarify that any profits received from carried interest is subject to partnership taxation, and the income in the manager's tax return will have the same characteristics as the income in the partnership.[98] Also, although hedge fund managers' strategies vary, many of them look to leverage short term gains to maximize profits given that those types of short term capital gains are taxed at the ordinary income level. Therefore, carried interest issues with hedge fund managers' compensation are completely misconceived. The hedge fund industry tends to have more short-term capital gains than long-term. Moreover, certain industries, including private equity and venture capital funds, would suffer if legislation which taxes carried interest at ordinary income rates is approved. Before enacting these types of laws it is important to consider the effect that these industries have on the overall economy and if the approval of this type of legislation would displace these financial institutions (i.e. asset managers) to other countries where they cannot be taxed.

VI. HEDGE FUND MANAGER AND PUERTO RICO

Due to Puerto Rico's current state of economic turmoil, the Puerto Rico Department of Treasury desperately needs to raise revenues and the government needs to inject capital into the struggling economy. With the exit of various pharmaceutical companies and the government's increasing disregard towards a declining manufacturing sector, it is the right and

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[96] I.R.C. § 409A(a)(4)(B)(i) (2006); Treas. Reg. § 1.409A-2(a)(3) (2007) as cited in Melone, *supra* note 76, at 436, at note 73.

[97] *Id*.

[98] *Id*. at 422.

appropriate time for hedge fund managers to establish operations in the Island. Puerto Rico has a sophisticated financial sector and well-educated financial, accounting, and legal work forces as well as significant tax incentives for the financial management industry.

According to the "Economic Incentives Act for the Development of Puerto Rico," eligible services dedicated to foreign markets include:

> "(2) Investment banking and other financial services including but not limited to services of: (i) asset management; (ii) alternate investment management; (iii) management of private capital investment activities; (iv) management of hedging funds or high risk funds; (v) pools of capital management; (vi) administration of trusts that serve to covert different groups of assets into securities; and (vii) escrow accounts administration services."[99]

Under this incentive legislation, hedge fund management companies would receive a preferential fixed income tax rate of 4 percent,[100] tax-exempt dividends and profit distributions from eligible businesses, and a 4 percent tax rate on the gains of the sale of shares, interests, and assets of the eligible businesses. [101] These incentives create a drastic reduction of tax liability for the hedge fund manager. Furthermore, if the shareholders of a Hedge Fund Management Company organized in Puerto Rico were to qualify as bona fide residents of Puerto Rico, under sec. 933 of the U.S. Tax Code, this individual would not have to pay U.S. federal taxes on his Puerto Rico source income. [102] He would pay federal taxes solely on his U.S. earned income. In this scenario, if a hedge fund manager moved to Puerto Rico and qualified as a bona fide resident, the tax rate on his portion of carried interest compensation (not

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[99] The "Economic Incentives Act for the Development of Puerto Rico," Act No. 73 of May 28, 2008 sec. 2 (h)(2) (Puerto Rico). (Available at http://www.oslpr.org/download/en/2008/A-0073-2008.pdf (last viewed January28, 2011)).

[100] *Id*. at §3 (3)(a).

[101] *Id*. §3(3)(d)(2) and (3).

[102] I.R.S., Publication 1321, Special Instructions For Bona Fide Residents Of Puerto Rico Who Must File A U.S. Individual Income Tax Return (Form 1040 or 1040A) http://www.irs.gov/pub/irs-pdf/p1321.pdf (last visited Jan. 28, 2011).

deemed U.S. effectively connected income) would be exempt from U.S federal taxation, and would only be subject to Puerto Rico's 4 percent fixed tax rate.

In order for these incentive laws to apply, the hedge fund management company must be established in and export services from Puerto Rico. This is fairly easy task using a master feeder structure, where the master fund is established in a tax haven jurisdiction like the Cayman Islands – not triggering any U.S. effectively connected income- and its feeder funds are organized according to the hedge fund's clientele. In this structure, like in a typical U.S. hedge fund structure, the hedge fund manager established in Puerto Rico would be the general partner in the limited partnership established in the Cayman Islands. Under this organizational scheme, the Puerto Rico incentive laws would apply since the service is being exported to the Cayman Islands. Consequently, it would effectively work to legally reduce the impact of U.S. Federal Taxation.

These incentive laws create a great opportunity for hedge fund managers. Even though their compensation is under significant scrutiny, these laws would give them a chance to lower their tax liability and escape the problematic compensation issue. The main problem this proposed structure entails is Puerto Rico's government. Political and fiscal implications may motivate the government to establish rash taxing policies that could have serious repercussions on eligible exempt businesses. This is illustrated by the enactment of Act 154 of October 25, 2010 by means of which the P.R. government changed the income sourcing rules and placed an excise tax on sales between affiliates of multinational manufacturing companies.[103] Nevertheless, this is only a consideration in the complete decision to establish a Hedge Fund Management Company in Puerto Rico. It could well be asserted that the established tax incentives outweigh the risks and potential downfall.

VII. CONCLUSION

The hedge fund industry is undeniably an important part of the global financial markets, where its creative structuring and tax planning exemplify the real challenges in this field. Hedge Funds and Hedge Fund Managers deal

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[103] 2010 P.R. Laws No. 154; as amended by 2010 P.R. Laws No. 157.

with an immense number of issues ranging from taxation, accounting, regulations, and even public relations. It is essential that government agencies and institutions understands that this industry is one which will be long lasting and tries to encourage their practices, all the while looking out for the public's well being. A hedge fund's day-to-day business is already overly stressful and demanding, without acknowledging the legal taxation issues. These legal taxation issues further complicate the matter, even though they play a small part in the general scope of the business, taxes can boost or shatter profits.

UN MODELO PARA LA IMPLANTACIÓN DE UNA CONTRIBUCIÓN INTERNACIONAL PARA ENFRENTAR LA CRISIS SOCIO-ECONÓMICA MUNDIAL

NOTA

MARIANGELY GONZÁLEZ TOBAJA*

Turning a global crisis into a global opportunity
Lema de la campaña del *Robin Hood Tax* en Inglaterra[1]

I. INTRODUCCIÓN

Pobreza, analfabetismo y calentamiento global. Éstos son algunos de los problemas con los que batallan países y organizaciones diariamente. A pesar de los múltiples intentos por erradicar estos males, aún no ha sido posible implementar una solución permanente en pleno siglo XXI. Esto contrasta con el considerable avance tecnológico y abundante adquisición de riquezas por parte de gobiernos, corporaciones e individuos. Parece ser que *Robin Hood* y sus hombres deberían robarle a los ricos para luego distribuirlo entre los pobres y así lograr una equitativa asignación de los recursos.

Ahora bien, ¿qué tal si utilizamos la lógica de Robin Hood para diseñar un mecanismo contributivo internacional que genere fondos suficientes para la implantación de soluciones reales y permanentes a la actual crisis mundial? Este es precisamente el objetivo de los proponentes del impuesto denominado *Robin Hood Tax*.

Pretendemos presentar algunas de las alternativas propuestas, basadas en la tributación de instituciones financieras, para enfrentar los perjudiciales cambios climatológicos, la indigencia, así como el aumento los servicios públicos ofrecidos por los gobiernos. Realizaremos el análisis atendiendo principalmente las consideraciones contributivas de las

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[1] Véase The Robin Hood Tax, http://robinhoodtax.org/ (visitado el 30 de diciembre de 2010).

diferentes ideas propuestas. Iniciaremos la discusión exponiendo un transfondo sobre el tema el cual luego se concentrará en lo que se conoce como el *Robin Hood Tax*. Asimismo examinaremos las ventajas y desventajas del mencionado impuesto, al igual que atenderemos los asuntos sobre la viabilidad de su implementación.

El *Robin Hood Tax* se refiere a un conjunto de impuestos a transacciones de valores financieros. Esto incluye la compra y venta de acciones, bonos, fondos mutuos, opciones, cambio de moneda extranjera, entre otras. Los bancos y otras instituciones financieras tendrían la obligación de pagar un 0.005 por ciento (0.005%) del valor de cada transacción de valores, lo que representa cinco centavos por cada mil dólares intercambiados.[2] La contribución propuesta tiene un extraordinario potencial para generar cuantiosos ingresos. Según sus proponentes en Australia:

> If implemented on a global basis, the tax's projected revenue could be as much as US$400 billion a year, depending on the size of the levy imposed, the size of the reduction in trading (if any), and the number of implementing countries or jurisdictions. In the US alone it has been estimated that annually, between US$177 and $353 could be raised.[3]

Los grupos que apoyan la implementación de este impuesto a transacciones financieras de activos, sugieren que el dinero recaudado se distribuya de la siguiente manera: la mitad de los fondos se utilizarían por el gobierno nacional para cubrir el déficit presupuestario (si alguno), pagar la deuda pública existente y ofrecer mejores servicios a sus ciudadanos.[4] La

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[2] (Según los propulsores del impuesto Robin Hood, se podrían utilizar diferentes tasas para las varias transacciones que tributarían). Véase: The Robin Hood Tax How it Works, http://robinhoodtax.org.au/how-it-works/ (visitado el 30 de diciembre de 2010).

[3] The Robin Hood Tax Facts, http://robinhoodtax.org.au/facs (visitado el 30 de diciembre de 2010).

[4] (Existen varias campañas a nivel internacional con el objetivo de reclutar simpatizantes al "Robin Hood tax" a través de la educación y concienciación de su utilidad social. Actualmente se manejan campañas en: Inglaterra, Canadá, España, Italia, Francia, Austria, Bélgica, Alemania y Holanda. Específicamente en Inglaterra, la misma la dirige una coalición de aproximadamente 112 organizaciones y grupos caritativos. Entre éstos se encuentran: The Salvation Army, UNICEF UK, Comic Relief, Friends of the Earth, Hope for Children, War on Want, Christian Aid, Stamp Out Poverty, Family Action y Oxfam. Véase: The Coalition, http://robinhoodtax.org/whos-behind-it/the-coalition, visitado el 30 de diciembre de 2010 y Around the World, http://robinhoodtax.org/whos-behind-it/around-the-world, visitado el 30 de diciembre de 2010.

porción restante se distribuirá a países en vías de progreso para que logren las metas de desarrollo del milenio[5] y se mitiguen los daños causados por los cambios climáticos.

La pregunta que surge en este punto es, ¿por qué los bancos y otras instituciones financieras deben pagar para combatir esta crisis mundial? Primeramente, se debe tener en cuenta que durante los próximos años, se vislumbra un panorama de crecimiento para la industria bancaria. De hecho varios investigadores, en el artículo *What's in Store for Global Banking*[6], señalaron que, a pesar de la significativa corrección cíclica que experimentaron los bancos a nivel mundial para fines de 2007, sus ganancias se duplicarían para el año 2016. Se pronostica que para dicho año, la capitalización de mercado de los bancos será aproximadamente $12 trillones más que en la actualidad.[7] Se estima que los ingresos de esta industria continuarían aumentando en una proporción mayor al crecimiento del producto nacional bruto.

El informe de junio de 2010, preparado por el Fondo Monetario Internacional para la reunión de la organización G-20[8] que se celebraría en Toronto, Canadá, presenta las alternativas que los países han establecido o considerado para que el sector financiero realice un "…*fair and substancial contribution toward paying for any burden associated with government interventions to repair the banking system*."[9]

Durante la reciente crisis financiera muchos de los gobiernos miembros del G-20 se vieron forzados a recurrir a medidas extraordinarias tales como aumentos en la cubierta de seguro de depósitos, compras de

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[5] Se refieren a ocho metas que los países miembros de las Naciones Unidas y varias organizaciones internacionales, se propusieron cumplir para el año 2015. Estos objetivos se establecieron en la Declaración del Milenio de las Naciones Unidas, la cual se firmó durante septiembre de 2000. A continuación se mencionan los ocho fines: erradicar la pobreza extrema y el hambre, promover la igualdad de géneros y fortalecer a la mujer, reducir la mortalidad infantil, mejorar la salud mental, combatir el virus del HIV/SIDA, la malaria, entre otras enfermedades mortales, asegurar la sostenibilidad ambiental y establecer un acuerdo mundial para el desarrollo). Véase: *Millenium Development Goals*, http://www.who.int/topics/millennium_development_goals/en/, visitado el 22 de enero de 2011.

[6] Miklos Dietz *et al*., What's in Store for Global Banking, The McKinsey Quarterly, Enero 2008.

[7] Id. en la pág. 1.

[8] Este término se refiere al grupo de veinte ministros de finanzas y dirigentes de bancos centrales de varios países que se creó en el año 1999 luego de las crisis financieras que ocurrieron para fines de esa década. El propósito es favorecer la libre discusión entre naciones industrializadas y aquellas emergentes sobre asuntos pertinentes a la estabilidad económica mundial. Japón, Francia, China, Alemania, Argentina y Rusia son algunos de sus miembros. Véase: *About G-20*, http://www.g20.org/about_index.aspx, visitado el 22 de enero de 2011.

[9] International Monetary Fund, A Fair and Substantial Contribution by the Financial Sector: Final Report for the G-20 6 (2010), http://www.imf.org/external/np/g20/pdf/062710b.pdf.

activos, ofrecer garantías y provisiones de liquidez, para auxiliar a las instituciones bancarias. Se estima que el costo fiscal de ayuda directa, excluyendo las cantidades recobradas a fines del año 2009, es 2.8 porciento (2.8%) del producto nacional bruto.[10] Sin embargo, los datos del año 2010 recopilados hasta el momento del informe, apuntaban a que la recuperación de los bancos en algunos países, podría reducir sustancialmente los costos netos de la crisis. A pesar de la compensación esperada, los costos finales podrían subestimar la grave exposición fiscal suscitada durante la debacle financiera. Los costos económicos y sociales relacionados con ésta pudieran resultar ser sustancialmente mayor a los estimados. Se proyecta que la deuda gubernamental de las naciones avanzadas que componen el grupo G-20 incrementará, en promedio, cerca de un 40% del producto nacional bruto durante el período de 2008 al 2015.[11] Este aumento estará mayormente relacionado con la crisis financiera mundial, cuyos efectos se hicieron más patentes desde mediados de 2007 hasta el año 2008, a pesar de que comenzó a desarrollarse desde antes.[12]

Se han propuesto –y en algunos países adoptado- varias medidas para garantizar que las instituciones bancarias retribuyan al gobierno los recursos empleados en las intervenciones pasadas y se responsabilicen por sus prácticas excesivas de riesgo. Entre éstas se encuentran, gravámenes a algunos activos del sector financiero y contribuciones en bonos. Por ejemplo, en Estados Unidos se propuso una tarifa[13] para recobrar los costos de la intervención gubernamental en la industria bancaria. Tanto Inglaterra como Francia implementaron una contribución provisional a pagos de bonos en exceso de cierta cantidad. Sin embargo, el debate público generado por la crisis ha resaltado la necesidad de acoger normas que le hagan frente a los peligros de las arriesgadas actividades bancarias de forma permanente. Una de estas proposiciones es un impuesto a transacciones financieras, como es el *Robin Hood Tax*.

II. TRASFONDO FÁCTICO

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[10] Id. en la pág. 7.

[11] Id. en la pág 7. En esta misma página se indica que, "[l]ooking to the wider economy, the cumulative output loss so far in those G-20 countries that experienced a systemic crisis is about 26 percent of GDP (gross domestic product)."

[12] Véase: Anup Shah, Global Financial Crisis, Dec. 11, 2010, http://www.globalissues.org/article/768/global-financial-crisis.

[13] Ésta se conocería como el *financial crisis responsibility fee*. Los bancos y otras instituciones financieras cuyos activos sobrepasen los $50 mil millones, pagarían un 0.15 por ciento de sus deudas (excluyendo los depósitos y reservas requeridas por la "Federal Deposit Insurance Company". Se estima que esta tarifa recaudará entre $90 y $117 mil millones durante un período de 10 a 12 años. Id. en la pág. 7

Luego del colapso de la política internacional sobre cambio de moneda extranjera conocida como Bretton Woods[14] en el 1971, varios economistas presentaron sus planes para una reforma en el sistema monetario internacional. Entre ellos, el ganador del Premio Nobel en Economía del año 1981, JAMES TOBIN, propuso una contribución a transacciones de intercambio de moneda extranjera. El impuesto serviría para reducir la especulación existente en los mercados internacionales de moneda. La misma no era bien vista puesto que se consideraba que generaba efectos perniciosos y contraproducentes en el sistema monetario. TOBIN introdujo esta idea en el año 1972, como parte de sus conferencias Janeway en la Universidad de Princeton. Posteriormente, su proposición fue publicada bajo el título *The New Economics One Decade Later* en el año 1974.

En otro de sus artículos, *A Proposal for International Monetary Reform*[15] JAMES TOBIN afirmaba que tanto las economías como los gobiernos nacionales no tenían la capacidad de adaptación necesaria para sostener desplazamientos significativos de fondos a través de mercados extranjeros. Como consecuencia, se afectaban los objetivos perseguidos bajo la política económica doméstica en términos de empleo, producción e inflación. Esto se debía principalmente a dos circunstancias: primeramente, la movilidad de capital financiero limita las posibles diferencias entre tasas de interés domésticas, restringiendo así la habilidad gubernamental y de bancos centrales de alcanzar políticas monetarias y fiscales apropiadas para sus particulares economías. Igualmente, la especulación en tasas de intercambio,

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[14] En el 1944 se estableció el sistema Bretton Woods para crear una base internacional para el intercambio de una moneda extranjera por otra. Esto se realizó como un esfuerzo para liberalizar el comercio internacional y sufragar la reconstrucción post-guerra, específicamente la Segunda Guerra Mundial. Como resultado de este régimen, también se fundó el Fondo Monetario Internacional al igual que el Banco Internacional para la Reconstrucción y el Desarrollo, conocido como el Banco Mundial. El plan diseñado por el reconocido economista John Maynard Keynes, requería que los países establecieran la tasa de intercambio de su moneda a base del dólar estadounidense. Los políticos de Estados Unidos le garantizaron a los demás miembros del acuerdo que su moneda era confiable ya que la sujetarían, a su vez, al valor del oro. Las naciones adscritas al convenio, se comprometían a comprar y vender dólares norteamericanos para asegurar que sus monedas se mantenían dentro de la tasa fija de uno porciento. Posteriormente los gobiernos comenzaron a controlar las importaciones y exportaciones como medida para contrarrestar los cortes de la guerra. Se manipulaba la moneda para estructurar el comercio foráneo. Esto junto con las restrictivas prácticas del mercado, contribuyeron a provocar la devaluación, deflación y depresión que definió la economía durante la década de 1930. Finalmente, este sistema colapsó cuando en el 1971, el Presidente Richard Nixon, notificó que el dólar estadounidense no continuarían siendo convertido a oro. Véase M.J. Stephey, A Brief History of Bretton Woods System, 21 de octubre de 2008, http://www.time.com/time/business/article/0,8599,1852254,00.html,(visitado el 16 de enero de 2011).

[15] James Tobin, A Proposal for Int'l Monetary Reform, 4 E. Econ. Journal 153 (1978).

al producir considerables cambios en activos y pasivos o en sí mismas, tenía efectos perjudiciales para la economía nacional ya que las políticas internas usualmente eran insuficientes para evadirla o contrarrestarla.

Existían dos caminos a seguir para combatir los detrimentos producidos por la volatilidad de las tasas de intercambio. La primera propuesta, según JAMES TOBIN, sería lograr una integración económica mediante el acuerdo de una moneda común y una política fiscal y monetaria universal. Sin embargo, esta no presentaba una opción viable en ese momento. Además, TOBIN concebía a la creciente integración económica mundial existente, como parcializada y desequilibrada a pesar de los beneficios generados. El problema radicaba en que los mercados financieros privados se habían globalizado más rápidamente en comparación con otros organismos políticos y económicos.

La segunda alternativa era posibilitar una mayor segmentación financiera entre naciones o mercados de monedas. Para lograr este fin, los bancos centrales y gobiernos ejercerían su autonomía para diseñar políticas y prácticas que respondiesen a las necesidades específicas de sus instituciones económicas. A base de este supuesto -segmentación entre mercados financieros de moneda extranjera-, JAMES TOBIN concibió su modelo[16]. El economista lo explicó de esta forma: *"[t]he proposal is an international uniform tax on all spot conversions of one currency into another, proportional to the size of the transaction*."[17] Añadió que *"[t]he tax would apply to all purchases of financial instruments denominated in another*

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[16] (James Tobin reconoce que su idea se basó en el trabajo de John Maynard Keynes. Al preguntársele en una entrevista qué lo incitó a idear esta contribución a cada transacción de cambio de moneda extranjera, declaró: "*I am a disciple of Keynes, and he, in his famous chapter XII of the General Theory on Employment Interest and Money, had already prescribed a tax on transactions, with the aim of linking investors to their actions in a lasting fashion. In 1971 I transferred this idea to exchange markets*.") *Véase* Der Spiegel, *James Tobin: "The antiglobalisation movement has highjacked my name"*, , 3 de septiembre de 2001, http://web.archive.org/web/20050306201839/http://www.jubilee2000uk.org/worldnews/lamerica/james_tobin_030901_english.htm. (A su vez, Keynes sostenía que para eliminar la volatilidad generada por la especulación excesiva, era necesario provocar un vínculo más duradero entre el especulador y la inversión. A estos efectos expresaba: "*…to make the purchase of an investment permanent and indissoluble…might be a useful remedy for our contemporary evils. For this would force the investor to direct his mind to the long-term prospects and to those only*.") *Véase*: JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 105 (Harcourt Brace Jovanovich ed., 1964). (Para lograr este objetivo, Keynes proponía la imposición de una contribución. *"[t]he introduction of a substantial government transfer tax on all transactions might prove the most serviceable reform available, with a view to mitigating the predominance of speculation over enterprise in the United States"*) *Véase*: JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 105 (Harcourt Brace Jovanovich ed., 1964).

[17] Tobin, A Proposal for Int'l Monetary Reform, *supra* nota 15, en la pág. 155.

currency –from currency and coin to equity securities."[18] Al imponer esta contribución global no sólo se mitigaría la inestabilidad económica –generada por la especulación a corto plazo- en cada país, sino que también tendría el efecto de reducirla a nivel internacional. Esto se lograría ya que se reduciría el incentivo de especular a corto plazo con el cambio de moneda extranjera. Para que este tipo de transacción sea rentable, se requiere que el cambio en el valor de la moneda sea en exceso a la contribución propuesta. Debido al menor margen de ganancia de estos breves intercambios monetarios, el impuesto tendría el efecto de reducir o hasta eliminar sus ingresos y, como resultado, desincentivar la especulación. Al reducir el volumen de transacciones especulativas, este mecanismo favorecería la estabilidad de las tasas de intercambio. Es importante que el impuesto fuese lo suficientemente bajo para sólo afectar las actividades de corto plazo y no influir en el comercio de bienes y servicios o inversiones a largo plazo.

Según la propuesta de JAMES TOBIN, se acordaría internacionalmente la imposición uniforme de esta contribución. Cada gobierno sería responsable de administrar el impuesto sobre su jurisdicción y sus recaudos se podrían remitir al Banco Mundial. Igualmente se le otorgaría a las naciones la potestad, sujeto a la autorización del Fondo Monetario Internacional, de convenir que la contribución no se cobraría en ciertos mercados monetarios. El impuesto tendría un impacto sustancial sobre las instituciones bancarias, a quienes en gran medida se les atribuían la inestabilidad en los mercados.

Principalmente el impuesto serviría para desalentar las transacciones a corto plazo de cambios de moneda foránea. De hecho para JAMES TOBIN "*…it is desirable to obstruct as little as possible international movements of capital responsive to long-run portfolio preferences and profit opportunities*."[19] Debe recordarse que este modelo parte de la teoría que la inestabilidad financiera se debía esencialmente a las actividades de breve duración.

El economista no estaba ajeno a las complejidades en términos de administración y cumplimiento que representaría imponer una contribución uniforme a nivel mundial. Incluso reconocía que podrían existir ingeniosos esquemas de evasión.[20] Sin embargo, afirmaba que a pesar de las dificultades que implicaría, éstas serían mínimas en comparación con los costos asociados a perseverar el sistema actual. James Tobin afirmaba que los países debían desarrollaban políticas nacionales que considerasen las consecuencias que tienen para el exterior. Puntualizaba que *"[t]ogether the major governments and central banks are making fiscal and monetary policy for the world, whether or not they explicitly recognize the fact*."[21]

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[18] *Id*. en la pág. 159.
[19] *Id*. en la pág. 155.
[20] *Id*. en la pág. 159.
[21] *Id.* en la pág. 159.

A pesar de que la contribución propuesta por JAMES TOBIN y la conocida como *Robin Hood Tax* son similares conceptualmente, ambas se diferencian principalmente en dos aspectos. Mientras que el *Robin Hood Tax* tiene el propósito de generar abundantes fondos para sufragar políticas que contrarresten los perjudiciales efectos de la crisis socio-económica mundial, el modelo de JAMES TOBIN busca afectar directamente el comportamiento de especuladores a corto plazo y así estabilizar los mercados monetarios. Igualmente, el *Tobin Tax* tiene un alcance de aplicación limitado pues sólo incluye transacciones relacionadas con el comercio de moneda. Por su parte, el *Robin Hood Tax* comprendería un mayor grupo de activos financieros, sin limitarse a acciones, bonos y opciones.

III. CONTRIBUCIÓN A TRANSACCIONES FINANCIERAS

Resulta pertinente definir qué es una contribución a transacciones financieras debido a que tanto el *Robin Hood Tax*, al igual que la propuesta por JAMES TOBIN pertenecen a esta clasificación.

Bajo este nombre - conribución a transacions financiaeras- se le conoce a aquella contribución que se impone sobre un tipo (o tipos) de transacción financiera para un cumplir uno o varios propósitos particulares. Es un término que recoge varias clases de impuestos que se pueden cobrar en el comercio de productos financieros. Entre estos se encuentran: las contribuciones sobre las transacciones de moneda, *stamp duty* y contribuciones a débitos bancarios.

La contribución sobre transacciones de moneda se refiere a un impuesto proporcional o porcentual sobre "*individual foreign exchange transactions, assessed on dealers in the foreign exchange market and collected by financial clearing or settlement systems*."[22] La misma tiene su origen en el modelo propuesto por JAMES TOBIN. A pesar de que ambos funcionan de la misma manera, los objetivos que persiguen son distintos. Mientras que el sistema de TOBIN pretendía reducir el movimiento de capital –producto de la especulación- a través de los mercados como un mecanismo de política monetaria para manejar la estabilidad de las tasas de intercambio, la contribución sobre transacciones de moneda persigue generar cuantiosas sumas de dinero sin provocar cambios de comportamiento en el mercado. Actualmente no opera este tipo contribución en ningún país.[23]

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[22] RODNEY SCHMIDT, THE CURRENCY TRANSACTION TAX: RATE AND REVENUE ESTIMATES, 3 (2008).

[23] *Taxing Banks: A Report submitted to the Intenational Monetary Fund*, http://www.taxresearch.org.uk/Documents/IMFTaxingBanks.pdf , en la pág. 24 (Febrero 2010).

Los *stamp duty*[24] se cobran al instante del intercambio de acciones e instrumentos financieros derivados. Sólo en raros casos, se aplica en el comercio de instrumentos de deuda. Un ejemplo de este tipo de contribución existe en Inglaterra, en el registro del título de un activo financiero. Tanto el "stamp duty" como el impuesto de timbre de reserva fiscal tienen una tasa fija de 0.5 porciento (0.5%) de lo que se paga por las acciones y no de su valor. La diferencia entre uno y otro es que el primero aplica cuando hay un documento físico sobre transferencia de la acción mientras que en el segundo, el intercambio se completa electrónicamente. Estas contribuciones aplican principalmente a transacciones de acciones de una compañía incorporada en Inglaterra o una entidad foránea que mantiene un registro de acciones en ese país. También incluye opciones de compra de acciones, derechos que surgen de las acciones y a la compra de intereses en la acción.[25] Las contribuciones a débitos bancarios operan mediante la imposición de una tasa fija a todos los cargos realizados en una cuenta bancaria durante un período establecido.

Este trasfondo servirá para evaluar la efectividad del *Robin Hood Tax.* Igualmente, será la base sobre la cual se introduzcan consideraciones sobre la viabilidad de su implantación y su funcionamiento.

IV. IMPLANTACIÓN

No existe un Derecho tributario internacional propiamente dicho. Joseph Isenbergh en su libro *International Taxation*[26] explica que el estudio de la tributación internacional se refiere mas bien a "…*international aspects of tax systems arising in national environments*." Además, aclara que este tema raramente se enfoca desde una perspectiva global. De lo anterior es posible inferir que el sistema tributario establecido en cada país, el cual varía considerablemente entre uno y otro, incide sobre el ámbito económico internacional. Para minimizar el impacto contributivo negativo que podría existir debido a la interacción de los heterogéneos sistemas contributivos nacionales, los gobiernos negocian tratados. Dichos acuerdos pretenden eliminar principalmente la múltiple tributación a la que estarían expuestos los ingresos que se mueven a través de los límites territoriales de varios países. Pero como todo convenio internacional, el mismo está sujeto a que los gobiernos firmantes den cumplimiento a las cláusulas pactadas.

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[24] (Antes se adhería un sello al documento como evidencia de pago, de ahí se deriva su nombre. Sin embargo, los sistemas modernos facilitan el cobro del impuesto y no es necesario que el esto ocurra). *Íd.* en la pág. 24.

[25] *Véase*: Directgov.uk, Tax on Buying Shares, http://www.direct.gov.uk/en/MoneyTaxAndBenefits/Taxes/TaxOnSavingsAndInvestments/DG_10013514, (visitado el 16 de enero de 2011).

[26] JOSEPH ISENBERGH, INT'L TAXATION 3 (2010).

En cuanto a los tratados internacionales, la Convención de Viena de la Ley de Tratados de 198027 es la fuente primaria y normativa. En dicho documento se recogen las reglas sobre la puesta en vigor, interpretación, aplicación, cierre y terminación de los acuerdos internacionales. El Artículo 26 presenta uno de los principios fundamentales del Derecho internacional público, *pacta sunt servanda*. Dicho principio significa que todo tratado en vigor obliga a las partes y debe ser cumplido por ellas de buena fe.28

Los gobiernos diseñan el sistema de tributación que regirá en su jurisdicción a base de diversos factores, entre ellos, necesidades del fisco, políticas económicas y programas de desarrollo. No existen normas de aplicación general que guíen su creación y como resultado, los esquemas tributarios varían considerablemente entre países. Estos regímenes de impuestos se clasifican principalmente en territoriales o extraterritoriales, dependiendo de dónde se generó el ingreso sujeto a contribución.

En un sistema de contribución territorial, sólo los ingresos generados dentro de los límites territoriales del país están sujetos a impuestos[29]. Sin embargo, si el gobierno impone el pago de contribuciones a los ingresos independientemente del lugar en el cual se generaron, se trata de un régimen de tributación extraterritorial[30]. Debe aclararse que el sistema tributario que gobierna en algunos países no se puede catalogar estrictamente como territorial o extraterritorial. Pueden encontrarse modificaciones o combinaciones de ambos esquemas.

Bajo el sistema tributario extraterritorial, el mismo ingreso podría estar sujeto a múltiple tributación. No sólo se le pagan contribuciones al país cuyo régimen es extraterritorial sino que también al gobierno donde se origina el ingreso. Como medida para mitigar el posible impacto negativo de la múltiple tributación, los países conceden reducciones o créditos, sujeto a ciertas limitaciones, por las contribuciones pagadas a otras jurisdicciones. Al incorporar estos créditos foráneos, el impacto del sistema extraterritorial se aproxima al del régimen territorial.

Las naciones cuyo sistema es territorial, se ajustan a otros esquemas tributarios al limitar el alcance de su imposición de contribuciones sólo a ingresos locales. El problema de múltiple tributación se elimina ya que bajo

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[27] *Véase*: Convención de Viena sobre el Derecho de los Tratados, 23 de mayo de 1969, 1155 U.N.T.S. 331.

[28] IGNACIO RIVERA GARCÍA, DICCIONARIO DE TÉRMINOS JURÍDICOS 393 (3ra ed., 2000); MANUEL DIEZ DE VELASCO, INSTITUCIONES DE DERECHO INTERNACIONAL PÚBLICO 1156 (17ma ed., 2007); 4-II JOSÉ RAMÓN VÉLEZ TORRES, CURSO DE DERECHO CIVIL. DERECHO DE CONTRATOS 99-100 (3ra reimp. 2006).

[29] JOSEPH ISENBERGH, s*upra* nota 26, en la pág. 137.

[30] *Íd*. en la pág. 9.

este esquema no se incluye como ingreso sujeto a contribución, aquél proveniente de fuentes foráneas, indistintamente de si es devengado por ciudadanos, residentes o extranjeros.[31] Sin embargo, la interacción de este tipo de sistema de impuestos nacional con otros iguales presenta la oportunidad para individuos y entidades de evadir su responsabilidad contributiva debido a principios y reglas de fuentes inconsistentes.[32] Por otro lado, estas desiguales reglas en diferentes países pueden también resultar en múltiple tributación a los mismos ingresos.

Para el diseño eficaz de una contribución internacional, como se pretende con el *Robin Hood Tax*, resulta imprescindible considerar los asuntos mencionados anteriormente. A continuación se examinan varios principios que se deberán incorporar en el análisis para el desarrollo efectivo de la contribución propuesta y se presentarán sus ventajas y desventajas.

El estudio debe iniciar con la aclaración de que existen diversas alternativas para guiar la concepción, administración e implantación del *Robin Hood Tax*. A pesar de que la idea es de fácil comprensión, requerirá gran trabajo técnico al igual que una activa negociación a nivel global.

A pesar de que el objetivo principal del *Robin Hood Tax* es la producción de cuantiosas sumas de dinero para destinarlo a fines sociales, es innegable que su imposición podría modificar los comportamientos en los mercados financieros, al igual que afectar la colección de otros impuestos. Incluso, los organizadores del grupo en apoyo de esta contribución en Australia, afirman que la reducción en transacciones especulativas a corto plazo será una consecuencia de su implantación.[33] Como este era precisamente la finalidad del *Tobin Tax*, resulta pertinente presentar las razones contra éste, pues también serán aplicables al proyecto Robin Hood.

Los críticos del *Tobin tax* intentan demostrar que la penalización por realizar transacciones a corto plazo como se pretende con su imposición, será ineficaz en mermar la volatilidad en los mercados.[34] Cuando se trató el tema sobre la propuesta de James Tobin, se explicó que la misma sostiene la hipótesis de que al desalentar las transacciones a corto plazo mediante la imposición de una contribución, se disminuiría la inestabilidad producto de la especulación. Esto a su vez resultaría en mejor rendimiento para los inversionistas a largo plazo o en niveles más predecibles sobre tasas de

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[31] *Íd*. en la pág. 14.
[32] *Íd.* en la pág. 14.
[33] *Véase*: *How it works, supra* nota 2.
[34] Aquellos a favor de la implantación de este impuesto pronostican un beneficio adicional de la reducción en la inestabilidad de las tasas de intercambio; "*…businesses would need to spend less money 'hedging' (buying currencies in anticipation of future price changes), thus freeing up capital for investment in new production*." *Véase*: *Time for Tobin!,* http://www.newint.org/features/2000/01/01/tobintax/, visitado el 23 de enero de 2011.

intercambio. Ante este objetivo se argumenta que la imposición de la contribución y consecuente incremento en los costos de transacción, actúan como un obstáculo a la inversión.

Ingrid M. Werner, de la Universidad de Ohio, señala que la evidencia empírica no apoya la tesis de que el *Tobin Tax* reducirá la volatilidad a través de los mercados globales de moneda.[35] Como apoyo a dicha aseveración, expresa que un estudio realizado en el 1993, concluye que una contribución a transacciones de intercambio de acciones implantado en Suecia durante el período de 1984 a 1991, tuvo el efecto de incrementar la volatilidad y una significativa reducción en la liquidez del mercado de viviendas en la medida que el volumen de tráfico se movió de Londres a Nueva York.[36] Por el contrario, otro estudio completado por unos investigadores, concluyó que la reducción en los costos transaccionales observados desde la década de 1970, en el mercado de intercambio extranjero, está relacionado con una disminución en volatilidad y un aumento en el volumen del tráfico en el comercio.[37]

Si en efecto el aumento en costos transaccionales ocasionado por el *Tobin Tax* o el propuesto Robin Hood produce una considerable baja en el volumen de transacciones de los activos financieros sujeto a contribución, esto a su vez resultaría en una reducción en los ingresos.[38] Se frustraría así el propósito que fundamenta la implantación del *Robin Hood Tax*, generar cuantiosas cantidades de dinero para proyectos de desarrollo y mejora mundial.

Se cuestiona también la implantación de una contribución a transacciones financieras, como lo sería la propuesta del *Robin Hood Tax*, ya que existen otros instrumentos más efectivos en términos estrictamente de producción de ingresos. Este tipo de impuesto tributa los intercambios entre negocios (donde ocurre la mayoría de las transacciones financieras), lo que se traslada en el incremento de precios a través de las etapas de producción. El aumento en el costo de realizar negocios, podría resultar en que se reduzcan los productos ofrecidos. Es por esto que si el único objetivo es

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[35] Ingrid M. Werner, *Comment on Some Evidence that a Tobin Tax on Foreign Exchange Transactions may Increase Volatility*, 7 EUR. FIN. REV. 511, 511 (2003).
[36] *Id*. en las págs. 511-512.
[37] *Id*. en la pág. 512.
[38] Véase: *The Robin Hood Tax*, 14 de febrero de 2010, http://freethinkingeconomist.com/2010/02/14/the-robin-hood-tax/, visitado el 30 de diciembre de 2011. (También la reducción en el volumen del tráfico de valores financieros, podría implicar una disminución en el empleo de entidades en el sector financiero y en las industrias que las apoyan).

generar ingresos, resulta más favorable tributar la producción directamente en lugar de las transacciones.[39]

Otra razón que se presenta contra el *Tobin Tax* es que afectará adversamente el mercado de intercambio extranjero.[40] La contribución pudiese ocasionar distorsión económica al no distinguir entre las transacciones financieras a largo plazo y aquellas de breve duración que resultan ser perjudiciales por ser especulativas.[41] No es correcto sostener que toda transacción a corto plazo es peligrosa para el mercado. El impuesto tiene la limitación de que no permite discernir entre transacciones de corto plazo beneficiosas para la economía y aquellas indeseables.[42]

Un sector de académicos, pronostican que cualquier intromisión provocaría ineficiencias en los mercados.[43] Otros, por el contrario, informan que el mercado actual no es eficiente y la reducción en la inestabilidad en la tasa de cambio de divisas, causada por la implantación del *Tobin Tax*, sería provechoso.[44]

Si el mercado resulta ser ineficiente, se convertiría en uno ilíquido. Los costos transaccionales, aumentarán no sólo por la imposición de la contribución, sino que también por la iliquidez. Los inversionistas exigirán un mayor rendimiento para compensar la reducción en liquidez, lo que se traduce en un aumento en el costo de capital para todas las entidades que emitan valores sujetos a la contribución.[45] Estas firmas se abstendrán de aprovechar oportunidades que de otra manera se hubiesen beneficiado y la industria será menos competitiva pues se dificultará la entrada a nuevos participantes.[46]

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[39] JOSEPH ISENBERGH, s*upra* nota 26, en la pág. 21.

[40] Amy Youngblood Avitable, *Saving the World One Currency at a Time: Implementing the Tobin Tax*, 80 WASH. U. L. Q. 391, 403 (2002).

[41] Fiscal Affairs Department, working paper, *Retarding Shor-Term Capital Flows Through Witholding Tax*, citado por Youngblood, *supra* nota 41, en la pág. 03 n. 44. El texto citado lee:

> *The IMF admits that this argument is valid not only for the Tobin Tax but also for unilateral measures, such as domestic taxes on financial transactions flowing in an out of a particular country. Id. The IMF counters this argument by balancing the relative cost of the economic distortion against the cost of instability within the foreign exchange market. Id. The IMF contends that, combined with the low administrative costs of implementing the tax with the use of existing domestic systems, any economic distortions created by the tax would be 'largely mitigated*.

[42] JOSEPH ISENBERGH, s*upra* nota 26, en la pág. 20.

[43] Youngblood, *supra* nota 41, en la pág. 403.

[44] *Id*. en la pág. 403.

[45] JOSEPH ISENBERGH, s*upra* nota 26, en la pág. 20.

[46] *Véase*: *The Robin Hood Tax*, *supra* nota 39.

Esto plantea la preocupación de que la carga del impuesto recaiga principalmente sobre los últimos usuarios, en vez de ser sufragado completamente por las instituciones financieras. Se sospecha que debido al aumento en el costo de capital que experimentarán las entidades financieras como consecuencia de la contribución, aumentarán más aún los precios de sus servicios y productos. Además, la carga contributiva se podría traspasar a los clientes (tanto negocios como individuos), en reducidos pagos de interés en cuentas de ahorros y aumento en el costo de préstamos.[47]

Los partidarios del *Robin Hood Tax* en Australia aceptan que con toda probabilidad los bancos de inversión le transmitirán parte del costo a los clientes (que tienden a ser grandes organizaciones corporativas con estrategias de inversión de alto riesgo), pero que el sector financiero absorberá mayormente el impacto.[48] Además sostienen que la rentabilidad de los bancos comerciales no se afectará significativamente ya que éstos no participan demasiado en el tipo de transacciones sujetas a la contribución.[49] Aseguran también que la situación de la mayoría de los inversionistas que compran y retienen valores financieros, al igual que los individuos, se mantendrá inalterada debido a que, usualmente, realizan pocas transacciones en sus portafolios.[50]

Otro obstáculo que presentan las contribuciones a transacciones financieras es que son propensas a evasión a través de la integración. Esto es, a realizarlas dentro de los negocios, en vez de entre entidades. Si no se establecen mecanismos adecuados, esta circunstancia resultaría en instituciones financieras aún más grandes.[51]

Todas estas consideraciones mencionadas arriba, servirán de trasfondo para el diseño de un modelo para la implantación del *Robin Hood Tax*. El esquema propuesto por Amy Youngblood Avitable en su artículo, Implementing the Tobin Tax,[52] servirá de guía para nuestra propuesta.

El *Robin Hood Tax* es posible de implementar en términos técnicos. Varios países-miembros de la organización G-20 tributan algunas transacciones financieras. Por ejemplo, Argentina le impone una contribución a pagos entre cuentas corrientes y Turquía tributa todos los recibos de bancos y compañías de seguros.[53] Se podría recaudar la contribución sobre valores que trafican en intercambios formales a través del

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[47] JOSEPH ISENBERGH, s*upra* nota 26, en la pág. 20.
[48] *Véase*: http://robinhoodtax.org.au/facs (visitado el 30 de diciembre de 2010).
[49] *Id*.
[50] *Íd*.
[51] JOSEPH ISENBERGH, s*upra* nota 26, en la pág. 21.
[52] Youngblood, *supra* nota 41
[53] JOSEPH ISENBERGH, s*upra* nota 26, en la pág. 19.

mecanismo de retención en el origen[54] por un "central counterparty clearing house".[55][56] Esta solución sería bastante directa y económica. Sin embargo, el "Robin Hood tax" incluiría tanto aquellas transacciones en mercados financieros que se realizan en intercambios centralizados como aquellas realizadas *over the counter* ("O.T.C."). Algunos de los instrumentos, como los bonos y derivados, a los que les aplicaría el impuesto no se trafican en intercambios formales. También, ciertas acciones incluidas en intercambios reconocidos, se venden *over the counter*.

Usualmente estos valores se intercambian mediante acuerdos entre corredores y distribuidores (como bancos de inversión).[57] Por tratarse de convenios privados no existe un *central counter-party*. Esto presenta un problema de fiscalización del impuesto, ya que los requisitos de divulgación son mínimos en comparación con los que se exigen en un intercambio formal de instrumentos financieros. Para evitar esto, es posible limitar el impuesto sólo a transacciones que se realizan a través de centros de intercambio establecidos. Pero esta limitación podría entonces estimular el traslado de las transacciones a vías menos seguras. Si se aplicara el *Robin Hood Tax* también a transacciones *over the counter*, se deberá ordenar por ley que los corredores realicen la retención en el origen del impuesto correspondiente a la transacción y lo remitan al gobierno. Al igual, se tendrían que incrementar los requisitos de divulgación de estos bancos de inversiones para asegurar el cumplimiento con su obligación. A pesar de estos problemas, comunes a otros impuestos, existe un mecanismo adecuado para la práctica implementación de una contribución a transacciones financieras.[58]

En cuanto a la implantación del *Robin Hood Tax*, AMY YOUNGBLOOD AVITABLE propone dos opciones.[59] La primera alternativa sería la creación de una organización internacional para su implementación y asegurar su cumplimiento a nivel global. Esto sería consistente con el objetivo del *Robin Hood Tax*, la re-distribución de las riquezas para combatir problemas

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[54] Se sugiere esta opción ya que este eficaz procedimiento de cobro de contribuciones existe en muchos países.

[55] JOSEPH ISENBERGH, s*upra* nota 26, en la pág 19.

[56]Usualmente, los principales bancos del país se encargan de su operación para proveer eficiencia y estabilidad en los mercados financieros. Éstas asumen la mayoría del riesgo de crédito en la transacción. Un *central counterparty clearing house* realiza dos procesos durante la negociación: *clearing* y *settlement*. *Clearing* se refiere a la identificación de las obligaciones de las partes y el *settlement* ocurre cuando se transfieren finalmente los valores y fondos. *Véase*: *Central Counterparty Clearing House*, http://www.investopedia.com/terms/c/ccph.asp, visitado el 24 de enero de 2011.

[57] Véase: *Over the Counter,* http://www.investopedia.com/terms/o/otc.asp, visitado el 24 de enero de 2011.

[58] JOSEPH ISENBERGH, s*upra* nota 26, en la pág. 19.

[59] (La mayoría de los comentarios a continuación, se encuentran en las páginas 406-410 del artículo de Amy Younglood) *Véase* :Youngblood, *supra* nota 41, a las págs. 406-410..

mundiales, porque para lograrlo se requeriría cooperación a nivel internacional, y representaría interdependencia económica.

Una de las ventajas que presenta la implantación de esta contribución a través de una entidad internacional, es que garantiza que ésta sea uniforme. Además, una organización que opere al amparo de una institución internacional reconocida, como las Naciones Unidas o el *World Bank*, permitirá que se aprovechen sus mecanismos de solución de disputas.

El mayor obstáculo que presenta esta alternativa es que ignora quién posee la prerrogativa de la imposición de contribuciones. En la mayoría de los países, esta facultad es exclusiva de la legislatura e incluso, indelegable a otras ramas del gobierno o grupos privados.[60] Además, se requiere lograr una amplia aceptación y, sobre todo, cooperación a nivel internacional para lograr la implantación del "Robin Hood tax". Este esfuerzo deberá estar guiado por una serie de principios internacionalmente aceptados. Dicho acuerdo deberá estipular, entre otras cosas: ¿cuál será la tasa que se utilizará para el impuesto?, ¿quién tendrá la responsabilidad contributiva?, ¿en qué momento de la transacción se cobrará el impuesto?, ¿qué valores financieros estarán sujetos a la contribución?, ¿cuál será la base contributiva? [61] y ¿para qué se destinará el dinero que se recaude?

Mencionamos que actualmente no existe un Derecho tributario internacional y por ende se carecen de reglas de aplicabilidad general. Es por esto que los países dependen de tratados que definan las relaciones producto de la interacción de los diversos sistemas contributivos nacionales. A su vez, estos acuerdos se rigen por los principios del Derecho internacional público, que en última instancia depende de la cooperación y la buena fe de las naciones.

La otra alternativa es mediante el uso del sistema tributario del país para implantar el *Robin Hood Tax* a nivel local. Esta opción sería más económica que establecer una organización internacional puesto que aprovecharía el conocimiento, experiencia, la tecnología y las instituciones existentes en los sistemas nacionales. Los mecanismos de cobro y cumplimiento establecidos, facilitarán la implantación del impuesto propuesto.

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[60] ("*Article I, § 8 of the Constitution enumerates the powers of Congress. First in place among these enumerated powers is the "Power To lay and collect Taxes, Duties, Imposts and Excises*....") Skinner v. Mid-America Pipeline Co., 490 U.S. 212, 1732 (1989).

[61] (El economista Joseph Stiglitz ha sugerido que el impuesto aplique a toda clase de activos a base de su valor bruto para desalentar la creación de burbujas de activos). Véase: *Joseph Stiglitz Calls for Tobin Tax on all Financial Trading Transactions*, http://www.telegraph.co.uk/finance/financetopics/financialcrisis/6262242/Joseph-Stiglitz-calls-for-Tobin-tax-on-all-financial-trading-transactions.html, visitado el 24 de enero de 2011.

Sin embargo, los países no considerarán esta opción atractiva, a menos que otros gobiernos también acuerden implantar el *Robin Hood Tax.* El establecer el impuesto en algunas naciones y otras no, podría causar el traslado de las operaciones a países que imponen poca o ninguna responsabilidad contributiva *tax havens*.[62]

Otro de los riesgos que presenta esta segunda alternativa, es que los gobiernos podrían retener los fondos recaudados en vez de contribuirlos a la comunidad internacional. De igual manera, los países y las organizaciones participantes en la implantación del *Robin Hood Tax* requerirán que los gobiernos e instituciones que reciben el dinero lo utilicen apropiadamente. Para esto, se podrá crear una entidad internacional que de forma periódica audite el uso de los fondos.

De lo discutido es evidente que aún para la implantación del *Robin Hood Tax* unilateralmente por cada país, se necesita la cooperación internacional. Sin embargo, el esfuerzo sería menor que si se implantara la contribución a nivel internacional. Resulta esencial que se establezca un acuerdo sobre a quién se le cobrará el impuesto y en qué momento. Ya se mencionó en la nota al calce 56 que las transacciones de valores en los intercambios formales, ocurren en dos etapas. Cuando se determinan las obligaciones de las partes y cuando en efecto, se completa la transferencia de fondos. Para el que el *central counterparty clearing house* pueda realizar la retención en el origen, se deberá cobrar el impuesto al momento del traspaso del dinero.

A pesar de que se ha establecido que el *Robin Hood Tax* se debe cobrar sobre el valor bruto de la transacción, sobre la base más amplia posible y, por ende, tanto a entidades domésticas como foráneas[63], esto no presenta problemas al distinguir entre sistemas tributarios territoriales y extraterritoriales. La transacción sólo ocurrirá en un sólo lugar por lo que no supondrá el problema de múltiple tributación que ocurre con los ingresos.

V. CONCLUSIÓN

La implementación del *Robin Hood Tax* por cada país en vez de que sea a través de un organismo internacional, ofrece el beneficio de que se aprovechan los mecanismos de administración y cumplimiento ya existentes, además de que se respeta la soberanía nacional en la imposición de contribuciones. A través de este trabajo se propuso que se implantara a

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[62] *Véase*: *Tax Haven*, http://www.investopedia.com/terms/t/taxhaven.asp, visitado el 24 de enero de 2011.

[63] *Véase*: Vincent Oratore, *European Commission's Future View of Financial Services Taxation: Exploring a Financial Transactions Tax and Financial Activities Tax*, en las págs. 30-37, http://www.ey.com/Publication/vwLUAssets/Tax_Policy_and_Controversy_Quarterly_Briefing:_October/$FILE/Tax_policy_nov.pdf, visitado el 24 de enero de 2011.

través de la retención en el origen en el momento en que se transfieran los fondos de la transacción. Los *central counterparty clearing houses* tendrían la obligación de retener el impuesto y remitirlo al gobierno. Una alternativa es que la implementación se realice por etapas, pactando acuerdos entre países con políticas afines, como por ejemplo, la Unión Europea.

Resulta evidente que el mayor obstáculo que encara la implantación del *Robin Hood Tax* es la oposición política. Es muy posible que este esfuerzo sea infructuoso debido a la falta de colaboración a nivel internacional para establecer cuál es el instrumento más adecuado para la producción de los fondos necesarios y a qué causas sociales se asignarán. El 27 de junio de 2010, el grupo de los G-20, rechazó definitivamente la idea de *one-size fits all bank tax*.[64] Aún así los países unilateralmente podrán decidir si imponen un impuesto a las instituciones financieras para que realicen un *fair and substancial contribution* a las finanzas públicas para restablecer los fondos desembolsados en la asistencia a la industria bancaria durante la reciente crisis económica.

El economista internacional Julian Jossep afirma que debería implementarse alguna contribución que penalice las transacciones a corto plazo especulativas para que los bancos mantengan mayor capital en vez de inversiones riesgosas. La crisis financiera ha demostrado que los mercados necesitan mecanismos que los regulen. Sin embargo, está en desacuerdo con los proponentes del *Robin Hood Tax*, en cuanto al uso de los ingresos. Tal y como afirma Jossep: *"[i]f we are serious about meeting our commitments on tackling global poverty or climate change, should we not make this an absolute priority regardless of where the money comes from?*"[65]

Proponemos, en la eventualidad de que se implante una contribución cuyos fondos se destinarán a causas sociales, que se evaluúen las alternativas desde una perspectiva nacional y no internacional. A pesar de que el propósito de este escrito ha sido demostrar que es posible la implementación de un impuesto a nivel internacional, no existe la cooperación política necesaria para lograrlo, sobretodo, cuando el grupo G-20 indicó recientemente que no apoyaría este proyecto. Igualmente, se ignoraría la falta de legitimidad de cualquier organismo internacional que intente ponerlo en vigor, ya que el poder de imponer contribuciones es uno inherente al soberano. Otro gran obstáculo es que los acuerdos realizados se

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[64] *Véase*: Madhavi Acharya & Tom Yew, *Banks Relieved as G20 Backs Off on Bank Tax*, http://www.thestar.com/business/bank/article/829540--banks-relieved-as-g20-backs-off-on-bank-tax, visitado el 24 de enero de 2011.

[65] Julian Jessop, *A Robin Hood Tax: Would it Work?,* Accountancymagazine.com 18 (Abril 2010).

tendrán que subordinar a la buena fe de los países. La única alternativa viable sería la implantación de una contribución a transacciones financieras a nivel doméstico y que cada nación determine el fin socio-económico para el cual destinará los recaudos. Después de todo, una de las funciones de un sistema contributivo es la re-distribución de las riquezas.

THE ARM'S LENGTH STANDARD VS THE COMMENSURATE WITH INCOME STANDARD: TRANSFER PRICING ISSUES IN THE VALUATION OF INTANGIBLE ASSETS

NOTE

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I. INTRODUCTION

Transfer prices are "prices required to be reported in related-party transactions for tax purposes."[1] During the past several decades, globalization has provoked multinational enterprises (hereinafter MNEs) to use or misuse transfer pricing rules in their international transactions. Even more, international transfer pricing rules for intangibles have represented a significant concern for both MNEs and tax authorities worldwide.

In light of recent developments, intangibles have been one of the main reasons for litigation and disputes between United States Congress, the United States Treasury Department and taxpayers. Moreover, the enactment of the commensurate with income standard has raised some serious issues with regard to its relationship with the arm's length standard; the basic principle that permeates transfer pricing.

In this work, the connection between these two standards will be studied. First, we will describe briefly the importance of how intangibles are defined within the United States Treasury Department Regulations (hereinafter Treasury Regulations) and why their valuation is of outmost importance. Next, an analysis of section 482 of the Internal Revenue Code (hereinafter I.R.C.) and its regulations will be presented. Afterwards, the two

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[1] Yariv Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes,* 28 VA. TAX REV. 79, 81 (2008).

standards will be explained and compared. Finally, conclusions will be drawn based on recent case law interpreting these standards.

II. INTANGIBLES AND THEIR VALUATION

Intangible assets are commonly the most difficult assets to appraise. From problems related to their development and protection, to valuation and regulation, they have become the most expensive assets to work with. Treasury Regulations have defined intangible assets to include: (1) patents, invention, secret processes and formulas, designs, patterns, and know-how; (2) copyrights and literary, musical, or artistic compositions; (3) trademarks, trade names, and brand names; (4) franchises, licenses, and contracts; (5) methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, mailing lists, and technical data; (6) goodwill, related market position, customer acceptance, and distributing and servicing organizations; and (6) key employees.[2]

These intangibles often constitute the most important assets of MNEs. For this reason, any international transaction necessarily revolves around these assets and consequently their valuation. The need to assign a value to these nonphysical assets has always been challenge. Because of their unique characteristics and in many occasions the lack of comparable assets in the market, the valuation process can be very complicated.

In the next sections, the problems related to the valuation of these intangibles using the arm's length standard and/or the commensurate with income standard would be explored. But first, it is important to explain when and where did this controversy arise.

III. THE BEGINNINGS OF SECTION 482

> In any case of two or more organizations, trades, or businesses . . . owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property . . . the income with respect to

[2] Treas. Reg. § 1.482-2(d).

> such transfer or license shall be commensurate with the income attributable to the intangible.[3]

From the early days of multinational entities and international transactions, manipulation of transfer prices has been an issue for the United States Treasury Department (hereinafter Department). Throughout the years, they have tried to control the artificially priced transactions between related parties in order to strengthen the Department's oversight control of these transactions. These attempts go as far back as to the end of World War I with the War Relief Act of 1917, which tried to end these pricing abuses.[4] This first regulation allowed the commissioner to "require related corporations to file consolidated returns 'whenever necessary to more equitably determine the invested capital or taxable income.'"[5] These returns provided detailed information on the corporations' relationships with other affiliates.

The Act of 1921, the first direct predecessor of the current section 482, further enabled the Internal Revenue Service (hereinafter I.R.S.) to require consolidated accounts and authorized the Commissioner to prepare consolidated returns for commonly controlled trades or businesses to compute their "correct" tax liability.[6] The principal reason for this legislation was the potential tax avoidance represented, to possessions corporations, who could not file consolidated returns with their domestic affiliates.[7]

Later in that decade, The Revenue Act of 1928 incorporated this provision under section 45. This section expressly "allowed the Commissioner to restate income to determine the 'true tax liability' of related domestic and foreign corporations"[8] in order to "prevent tax avoidance and to ensure the clear reflection of the income of the related parties".[9]

As early as the 1930s the Treasury Regulations of 1935[10] announced for the first time the arm's length standard as the fundamental principle behind current section 482: "[t]he standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another

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[3] I.R.C § 482 (2011).

[4] Arup K. Bose, The Effectiveness of Using Cost Sharing Arrangements as a Mechanism to Avoid Intercompany Transfer Pricing Issues with Respect to Intellectual Property, 21 Va. Tax Rev. 553, 557 (2002).

[5] TREASURY DEPARTMENT & INTERNAL REVENUE SERVICE, A STUDY OF INTERCOMPANY PRICING 6 (1988) (Discussion draft) [hereinafter White Paper], available at, http://www.archive.org/stream/ studyofintercomp00unit#page/n21/mode/2up.

[6] *Id.*

[7] *Id.*

[8] GARY C. HAUFBAUER & ARIEL ASSA, U.S. TAXATION OF FOREIGN INCOME 244 (2007).

[9] White Paper *supra* note 5, at 6.

[10] *Id.* at 7.

uncontrolled taxpayer".[11] Nevertheless, no specific guidance was given regarding allocation methods to be used. Instead, this decision was left to the courts to decide, who in turn interpreted the arm's length standard using a variety of methods including: whether the related parties received full, fair value, a fair reasonable price, or a fair price including a reasonable profit.[12]

Before the 1960s, the IRS worked primarily with enforcement of domestic issues.[13] It is not until the early 1960s when international transactions began to proliferate and section 482 began to gain popularity. The U.S. Treasury realized that section 482 was not effectively impeding the escape of U.S. income into other low tax jurisdictions where its foreign subsidiaries resided. In deliberations over the Revenue Act of 1966, the House of Representatives decided to adopt a proposal from the Ways and Means Committee to add a new subsection to section 482 that would require taxpayers to demonstrate the use of the arm's length standard in pricing their transactions or else an apportionment formula based on relative economic activities would be used.[14]

The House's version of the Bill was not ultimately adopted. Instead, the Conference Committee stated that section 482 already gave enough power to the Commissioner to allocate income and deductions to taxpayers. Nevertheless, prompted the Treasury to develop regulations which would "provide additional guidelines and formulas for the allocation of income and deductions in cases involving foreign income".[15]

The Treasury took action and in its Regulations of 1968, which still remain today unchanged in great part, reaffirmed the arm's length standard as a fundamental principle in transfer pricing transactions. These Regulations, contrary to the previous which only established the arm's length standard, also presented taxpayers and the Service greater guidelines for transactions concerning services, the license or selling of intangibles, and the selling of tangible property.

Regarding the sale or license intangible assets, the Regulations stated that in order to find the arm's length amount, "the standard to be applied is the amount that would have been paid by an unrelated party for the same intangible property under the same circumstances."[16] Where no unrelated

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[11] *Id.*

[12] Cases inconsistently decided what the arm's length standard meant, or if it even was necessary. *See* Seminole Flavor Co. v. Commissioner, 4 T.C. 1215 (1945); Hall v. Commissioner, 32 T.C. 390 (1959), aff'd, 294 F.2d 82 (5th Cir. 1961); and Frank v. International Canadian Co., 308 F.2d 520 (9th Cir. 1962).

[13] *Id.* at 6.

[14] HAUFBAUER & ASSA, *supra* note 8, at 245.

[15] White Paper *supra* note 5, at 10.

[16] *Id.* at 11.

party transactions where available, the regulations provide a list of 12 factor to take into consideration: prevailing rates in the industry, offers of competitors, the uniqueness of the property and its legal protection, prospective profits to be generated by the intangible, and required investments necessary to utilize the intangible.[17] However, no guidance was provided in the regulations regarding the use of these factors in finding the arm's length price.

These regulations are still today the fundaments of international transfer pricing practices. In the next section, the arm's length standard will be discussed in more depth.

IV. ARM'S LENGTH STANDARD AND SOME CASE LAW INTERPRETATIONS

The arm's length standard is the principal underpinning of mostly all international transfer pricing regulations. The basic idea behind this principle is that transactions among related (controlled) parties should be valued as if the transaction was done between unrelated parties. However, the scope of the arm's length standard has not been clear cut, especially in the case of intangible assets. Contrary to what one could think, the 1968 Regulations did not quite solve this problem. This can be evidenced by a group of cases that involved the transfers from parent companies to subsidiaries in tax havens like Puerto Rico.

Beginning with The Revenue Act of 1921 to its appeal in 1996, the Internal Revenue Code (the "Code") provided U.S. corporations several incentives when doing business in U.S. possessions. From 100% tax exemption or credit for a U.S. corporation's source income to 100% dividend-received deduction on distributions, U.S. possessions became the principal place of business for multinationals looking for tax breaks.[18] One of the first cases to be litigated was *Eli Lilly & Co. v. Commissioner.*[19] Eli Lilly had taken advantage of the tax incentives herein mentioned and had created a subsidiary in Puerto Rico. The parent company had developed two manufacturing intangibles for which afterwards deducted research and development costs. Later, Lilly made a section 351 tax-free transfer of the patents and manufacturing know-how to its subsidiary in Puerto Rico, retaining no rights in these transferred intangibles. The subsidiary manufactured the drugs in Puerto Rico and later sold them to Lilly, meaning that the subsidiary made all the tax free income while Lilly deducted all expenses; effectively having manipulated transfer prices. The Commissioner

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[17] *Id.*

[18] James M. O'Brien and Mark A. Oates, *Transfer Pricing: Puerto Rico Transfer Pricing Emerges … Again … As an Emerging Issue*, INT'L TAX J. 22 (March-April 2007).

[19] 84 T.C. 996 (1985), *aff'd in part, rev'd in part* in 856 F.2d 855 (1988).

argued that the subsidiary's ownership of the intangible should be disregarded and the profits generated by the intangibles should be allocated completely to Lilly. The Court, rejecting this argument, concluded that Lilly in fact was able to do the intangibles transfer because of Code Section 351. It determined that the Commissioner's allocation was unreasonable but recognized that it could allocate some of the income to the parent company since the fact that there was no lump sum payment, royalty, or cost sharing agreement, created a distortion of income between Lilly and the Puerto Rican subsidiary (not making it an arm's length transaction).[20] It further concluded that a profit split method should be used to allocate adequately the income between both (ignoring the fact that regulations stipulated three methods for arm's length pricing).[21] In conclusion, Lilly did get allocated some of the profits generated by the intangibles, but the Court came up with its own methods, making no deference to the Commissioner's arguments.

Similarly, the Commissioner was also prevented from allocating all intangible profits transferred to a subsidiary in *G.O. Searle & Co. v. Comissioner*.[22] In this case, Searle, a U.S. parent corporation transferred ownership of U.S. patents and trademarks to a Puerto Rican subsidiary also pursuant to section 351. As a result of this agreement the taxpayer's income decreased by 50%. As in Lilly, the court accepted the non recognition transfer of the intangibles but determined that it did not receive an arm's length consideration and computed a royalty charge. The Court determined that a 25% rate of the subsidiary's net sales was reasonable but did not make any further analysis nor made any reference to the section 482 regulation methods or the comparables needed to determine the arm's length prices.

In Conclusion, these cases, among others,[23] are examples of how the courts tried to interpret the section 482 regulations and the arm's length standard. The courts did not follow the comparable methods mandated by the regulations and ended up determining what they thought was a "fair price" disregarding any analysis based on the methods on the Treasury

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[20] In appeal, the court rejected this conclusion and determined the transfer was an arm's length one.

[21] Section 482 regulations set out detailed rules for determining transfer prices of tangible property. It described three specific methods in order to find arm's length prices: comparable uncontrolled price method, resale price method, and the cost plus method. A fourth method should be used where none of the three methods can reasonably be applied. These methods should be used in the order set forth. In Lilly, the court rejected the use of the resale method (Lilly's argument) and the cost plus method (IRS argument) and used a fourth method. White Paper *supra* note 5, at 10.

[22] 88 T.C. 252 (1987).

[23] Hospital Corporation of America v. Commissioner, 81 T.C. 520 (1983); United States Steel v. Commissioner, 617 F.2d. 942 (2d Cir. 1980); Ciba-Geigy Corp. v. Commissioner, 85 T.C. 172 (1985).

Regulations. These cases triggered the Treasury to incorporate new regulations in order to better clarify the use of the comparable and the arm's length standard mostly because of the problems that confronted the valuation of intangibles.

In the next section, the 1986 regulations will be discussed specifically the incorporation of the new commensurate with income standard and its implications.

V. COMMENSURATE WITH INCOME STANDARD OF THE 1986 REGULATIONS

Pre 1986 cases brought uncertainty problems due to the lack of consistency when allocating income. This, primarily due to the problem of the valuation of the intangibles that were transferred. Congress, recognizing the problems the IRS was having applying and enforcing the arm's length standard,[24] enacted the last sentence of section 482 in an effort to deal with the transfer of intangibles between a parent company and its tax haven subsidiaries. The commensurate with income standard, or also called the super royalty provision, states: "In case of any transfer (or license) of intangible property… the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible".[25] This new provision not only captured section 351 transfers but also included licensing of royalty agreements which had also been a problem.[26]

This amendment requires taxpayers to consider the actual profit from the exploitation of the intangible. In other words, "each party earns the income or return from the intangible that reflects the economic activities undertaken by each party".[27] In determining the commensurate with income profit, two steps have to be followed. First it is required that the initial royalty agreement in the year of the transfer of the intangible be at arm's length.[28] This means that an analysis of the facts and circumstances at the time of the transfer should be made.[29] Moreover, the regulations introduced the concept of periodic adjustments after this initial assessment. This meant that the original transfer price would be adjusted periodically to reflect

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[24] Robert G. Clark, *Transfer Pricing, Section 482, and International Tax Conflict: Getting Harmonized Income Allocation Measures From Multinational Cacophony*, 42 AM. U. L. REV. 1155, 1177 (1993).

[25] 26 U.S.C.A. § 482.

[26] Josh. O. Ungerman, *The White Paper: The Stealth Bomber of the Section 482 Arsenal,* 42 SW. L. J. 1107, 1124 (1989).

[27] MONICA BOOS, INTERNATIONAL TRANSFER PRICING: THE VALUATION OF INTANGIBLE ASSETS 103 (2003).

[28] *Id.* at 104.

[29] *Id.*

unforeseen changes in the profitability of the intangibles transferred.[30] These rules allowed the IRS to make retroactive adjustments of the lump sum or royalty payments originally established.[31] These "adjustments made … [should too] be consistent with the arm's length standard".[32]

The enactment of these new regulations brought much controversy because of its apparent conflict with the already established arm's length standard. In the next section this controversy will be discussed and preliminary conclusions will be drawn.

VI. ARM'S LENGTH V. COMMENSURATE WITH INCOME

The fight between the arm's length standard and the commensurate with income standard had started. The first impressions were that "it evidence[d] a rejection of the arm's length standard in that unrelated parties typically do not deal with each other in such a matter".[33] As a result of these controversies, the Department of Treasury released the *Study on Intercompany Pricing*, also known as "The White Paper" in 1988.[34] The purpose of this Study was to further "reexamine [] the theory and administration of section 482, with particular attention paid to transfers of intangible property".[35] In this study, the Treasury acknowledged the fact the comparables are generally unavailable [in the case of intangible assets] and that "regulations fail[ed] to resolve the most significant and potentially abusive fact patterns".[36] It further tried to create an solution to one of the principal which was the implementation of the commensurate with income standard for when comparables did not exist. These were called the basic arm's length return method (BALRM) and the profit split addition to the BALRM.[37] However, because both methods were to be used when no comparables were available, it was considered a violation of the arm's length standard[38] since the basic principle behind this standard IS the use of comparables.

Despite of the criticism, The White Paper defended the use of these methods and categorically stated that "periodic adjustments [were]

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[30] 26 C.F.R. § 1.482-4(f).

[31] MONICA BOOS, *supra* note 27, at 104.

[32] 26 C.F.R. § 1.482-4(f)(2)(i).

[33] Marc M. Levey & Stanley C. Ruchelman, *Section 482-The Super Royalty Provisions Adopt the Commensurate Standard*, 41 TAX LAW 611, 636 (1988).

[34] White Paper *supra* note 5.

[35] *Id.* at 1.

[36] For a full discussion of these methods *see* White Paper *supra* note 5, at 34.

[37] *Id.* at 94-8.

[38] MONICA BOOS, *supra* note 27, at 98.

necessary in order to reflect the substantial changes in income…produced by a transferred intangible".[39] Moreover, it expressed that the period adjustments were consistent with the arm's length principle since "unrelated parties generally provide some mechanism to adjust for change in the profitability of transferred intangibles.[40] This last statement is, however, problematic. Some, following the White Paper's approach have agreed that between unrelated parties it is ordinary to enter into agreements where adjustment for royalties are provided depending on the profitability.[41] On the other hand, others have disagreed on this point, [42] rendering the commensurate with income inconsistent with the arm's length standard.

Those disagreeing on the fact that the new methods for adjustments were not quite consistent with the arm's length standard were not far from the truth. Controversy continued when the 1992 proposed regulations further moved away from the original BALRM and returned to the old comparable approach by "significantly broadening the concept of comparability as to ship around the problem of the lacking comparables".[43]

Finally, in 1994, the Treasury released the most current regulations related to the valuation of intangibles. In these, the arm's length standard was re-emphasized as the leading standard to be followed in setting prices for controlled transactions, the best method rule was introduced[44] and the concept of an arm's length range was established.[45] Furthermore, The regulations created exceptions (safe harbors) where no adjustments are necessary. This is the case when: (1) comparable transactions exist (the same intangible was transferred to an uncontrolled taxpayer under substantially the same circumstances) and can be used to apply the uncontrolled transaction method (CUT); [46] (2) if transactions involving comparable intangibles exist (not necessarily the same intangible or exact circumstances) no adjustments would be necessary if some conditions are met (e.g. written agreement exists and no changes in the consideration can be made);[47] (3) other methods different from CUT have been used and certain facts are cumulatively established;[48] (4) extraordinary events have

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[39] White Paper *supra* note 5, at 71.
[40] *Id*.
[41] Clark, *supra* note 24, at 1184.
[42] MONICA BOOS, *supra* note 27, at 104-5.
[43] *Id.* at 99.
[44] Contrary to the previous regulations that mandated a strict hierarchy of methods.
[45] Haufbauer & Assa, *supra* note 8, at 248.
[46] 26 C.F.R. § 1.482-4(f)(2)(i)(A).
[47] 26 C.F.R. § 1.482-4(f)(2)(i)(B).
[48] 26 C.F.R. § 1.482-4(f)(2)(i)(C).

occurred (e.g. natural disasters);[49] and (5) requirements under 2 and 3 have been followed for each year of the five-year period beginning with the first year in which substantial periodic consideration was required to be paid.[50]

In conclusion, the commensurate with income was somewhat relaxed with the creation of these new regulations. Some even have said it has lost relevance.[51] The fact that the commensurate with income standard has lost its relevance or not, can only be determined in the courts. As the next section explains, a court has been tempted to overrule decades of interpretations regarding the superiority of the arm's length standard in favor of the commensurate with income standard. The *Xilinix*[52] case will demonstrate that courts are still having difficulty understanding the transfer pricing regulations for intangibles and what consequences could this have in the future.

VII. THE XILINIX V. COMMISSIONER CASE AND ITS MEANING

Xilinix is a company in the business of researching, developing, manufacturing, marketing and selling programmable logic devices, integrated circuit devices and other development software systems. Xilinix (petitioner) and subsidiary XI entered into an agreement that provided that all new technology developed by either of both would be jointly owned. The relevant issue in this case arises because of Xilinix's Stock Option plan and its cost allocation. In 2000 the Commissioner issued notices of deficiencies stating that petitioner was required, pursuant to the cost-sharing agreement, to share the costs of certain stock option plans.

The Commissioner in what could be called a desperate move, argued that for purposes of determining that arm's length result in cost sharing arrangements, Congress intended for the commensurate with income standard to replace the arm's length standard. To what the Court answered: "The commensurate with income standard was intended to supplement and support, not supplant the arm's length standard. Nothing in section 482, its accompanying regulations, or its legislative history indicates that internal measures of cost and profit should be used to the exclusion of the arm's length standard."[53]

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[49] 26 C.F.R. § 1.482-4(f)(2)(i)(D).
[50] 26 C.F.R. § 1.482-4(f)(2)(i)(E).
[51] Yariv Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes,* 28 VA. TAX REV. 79 (2008).
[52] Xilinix v. Commissioner, 125 T.C. 37 (2005).
[53] *Id.* at 56.

Regardless of this defeat, the Commissioner appealed to the 9th Circuit and obtained a brief victory. On appeal,[54] the court completely disregarded the "supplement and support" argument of the tax court and stated that despite the unequivocal language of section 1.482-1(b)(1) of the Treasury Regulations indicating that the arm's length standard was to be applied in every case, section 1.482-7(d) specified that:

> [C]ontrolled parties in a cost sharing agreement must share *all* 'costs ... related to the intangible development area,' and that phrase is explicitly defined to include virtually all expenses not included in the cost of goods. The plain language does not permit any exceptions ... we conclude the two provisions establish *distinct and irreconcilable standards* for determining which costs must be shared between controlled parties in cost sharing agreements specifically related to intangible product development."[55]

It went even further to conclude that "the all costs requirement is irreconcilable with the arm's length standard"[56] and that they "were not persuaded by either party's attempts to harmonize the two provisions".[57]

The drastic conclusion of Judge Fisher received critics by a dissenting Judge Noonan. He expressed that the rule of thumb of "the specific controlling the general" used by majority was wrong. It branded it as simple and plausible, but wrong. In short words the judge said: "it converts a canon of construction into something like a statute. It ignores the international context and the Treasury's own practice".[58]

Finally, in a drastic withdrawal,[59] Judge Noonan writing the majority opinion affirmed in a very short decision the tax court's decision rendering the arm's length standard the superior one.

In conclusion, the XIlinix cases are a clear demonstration of the need of more guidance in the valuation of intangibles. The Commissioner's argument that the commensurate with income had replaced the arm's length standard, although theoretically wrong, shows that the standard lacks power to capture the income that is escaping to foreign jurisdiction and the desperate moves that the Commissioner will continue to make in order to stretch the scope of the standard. Although the 9th Circuit concluded that the commensurate with income standard does not replace the arm's length

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[54] Xilinix v. Commissioner, 567 F.3d 482 (2009).
[55] *Id.* at 488.
[56] *Id.* at 489.
[57] *Id.* at 490.
[58] *Id.* at 497.
[59] Xilinix v. Commissioner, 598 F.3d 1191 (2010).

principle, other Circuits are not precluded from making their own determinations and giving more power to the former.

In practical terms, this decision limits the Commissioner from collecting tax on income that is being retained in foreign tax havens. Additionally, it subordinates the commensurate with income principle to the arm's length standard leaving little space for their harmonization. As a consequence, being the arm's length standard the international principle governing transfer pricing, the commensurate with income standard could be eventually left in the darkness.

VIII. CONCLUSION

Definitively, the commensurate with income standard still needs more specific guidance in order to cope with the new global business developments and prevent its disappearance. Investors are everyday finding creative ways to lower their income taxes and the Treasury should be able to figure them out in time, before too much capital has escaped to other jurisdictions. With these new investment opportunities and ways of doing business this standard could be a useful tool for increasing collections.

Some have concluded that the arm's length method does not work well in theory or in practice.[60] New alternatives have been even proposed in the alternative, e.g. the formula based transfer pricing regime.[61] Despite these new methods that are being talked about, the reality is that the commensurate with income standard is part of our statute and we might as well make the best of it and propose new regulations to make it more effective while we decide whether to take another direction.

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[60] Martin A. Sullivan, *Drug Company Profits Shift Out of the United States*, Tax Notes (March 8, 2010) 1168.

[61] *Id.*; Brauner, *supra* note 51, at 160.

THE EXEMPT PORTFOLIO INTEREST SECTIONS OF THE INTERNAL REVENUE CODE AND THE UNDERLYING CAUSE OF THEIR EXISTENCE

NOTE

IGNACIO J. LABARCA MORALES*

I. INTRODUCTORY FRAMEWORK

The United States Taxation regime, on Inbound Taxation of foreign investors, has for the past few decades been concerned with two major focal points. These two main concerns pertain to the ascending collection of tax revenues[1] and the introduction of foreign capital, in reference to fiscal and economic aspects.

In order to develop the principal subject of this article, it is important to highlight and explain the nature of these two subjects, since it's precisely their conflicting nature what gives birth to the carefully crafted provisions of U.S. taxation framework regarding foreign investment. This paper will analyze how exactly these provisions are benefiting the U.S. taxation system and also stimulating foreign investment. All of this will be depicted in light of the tradeoff between inflation and unemployment rates that characterizes the monetary and fiscal policy concerns illustrated in the Philips' Curve.

We will also analyze the pros and cons of these provisions to both the U.S. tax regime and to foreign investors, applying close scrutiny to the general provisions as well as their practical effects on foreign investments.

II. INBOUND TAXATION OUTLINE

The U.S. Taxation regime is regulated by the Internal Revenues Code. In order to develop this article we need to directly compare and balance the ascending collection of tax revenue, as well as the introduction of foreign

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[1] JOSEPH ISENBERGH, INTERNATIONAL TAXATION 81-97 (3rd ed., Foundation Press 2010).

capital, in relation with the collection of tax revenue and the attractiveness of the dispositions of the tax regime to foreigners.

The Internal Revenue Code provides, in broad terms, that a foreign person is taxed at a flat rate of thirty (30) percent of their *gross* income derived from U.S. source passive investment.[2] Because this income is derived from predetermined and known sources, such as interests, dividends, rents and salaries, they are known as *fixed* or *determinable* income.[3] The regime is different, however, when the income is derived from business profits[4], which are taxed at full graduated rates on *net* profits.[5]

It is clear that these provisions would arise skepticism in any foreign citizen taking into consideration investing in a jurisdiction with a tax regime that doesn't have lower rate brackets for people like him and, additionally, imposes a thirty percent flat rate of their gross passive investment income.[6] Furthermore, following the 1986 Tax Reform Act, an additional tax of thirty (30) percent was imposed on the branch profits of foreign corporations in the United States when they are removed from U.S. business investments.[7] From this point of view, the scales shift up and down, respectively, between the tax regime and the introduction of foreign capital, while the collection of revenues outweighs the foreign capital concern. So the question arises, what incentive does a foreign citizen have to invest his capital in this scenario?

The answer to this question is found upon a closer study of the gaps in the flat rate tax on the investment of income of foreign persons. Other than real estate sales, capital gains from the sale of U.S. investment assets are exempt from taxation. Also, and very important, in order to appeal to foreign citizens, interest from U.S. bank deposits and from U.S. *portfolio* debt is also exempt from taxation.[8] This regulation also prevents foreign banks from gaining a competitive advantage over banks in the United States when making loans to American citizens outside of the United States. In this sense, professor Isenbergh stated the following:

> The overall pattern of U.S. taxation of foreign persons that emerges from these provisions is relatively benign taxation of passive

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[2] I.R.C §§ 871(a), 881 (2006).
[3] *Id.* at § 871(a)(1)(enumerating the items the flat rate tax regime applies to).
[4] Income that is effectively connected with the conduct of a trade or business in the United States.
[5] *Id.* at §871(b).*See also* § 882(a) and 884.
[6] *Id.* at § 873 & 882(c) (limitating deductions of foreign taxpayers to income effectively connected with a U.S. trade or business).
[7] *Id.* at § 47.
[8] ISENBERGH *supra*, note 1 at 82.

> investment income and more aggressive taxation of active business profits. This tax regime reflects, I believe, the combination of the large U.S. appetite for foreign capital that has developed in the last three decades and an accompanying wariness of surrendering day-to-day control over economic activity in the United States to foreigners. The need for foreign capital is the aftermath of American profligacy, both at home and abroad, that has transformed the United States since World War II from the world's largest exporter of capital to its largest importer.[9]

Upon reading this last statement, and the provisions of the Internal Revenue Code, it appears that the scales, in our comparison, shift in a different trend than before. This time substantial weight is added to the foreign capital concern in the American tax regime, while less importance is given to the concerns related to the collection of tax revenues. It's in this context that foreign citizens are more willing to invest in American banks and financial institutions, considering the attractiveness of an exempt *portfolio interest.*

III. THE EXEMPT PORTFOLIO INTEREST

The first item among the fixed or determinable income subject to U.S. taxation in the list of §871(a) of the Internal Revenue Code is interest. However, foreign persons are shielded from U.S. tax on interest received from a passive instrument and interest paid on deposits of U.S. banks or financial institutions.[10] The reason for this is the enactment of the Deficit Reduction Act of 1984[11] signed by President Reagan. By virtue of this act, particularly sections 871(h) and 881(c), professor Isenbergh explains, U.S. source interest from almost all types of debt obligations has been tax exempt for foreign persons. These provisions exempt from flat rate tax what they term *portfolio interest* received from the U.S. sources by foreign taxpayers.

A portfolio interest is defined as interest not derived from a U.S. business, paid on an obligation either in registered form with a foreign owner or issued with restrictions on U.S. ownership.[12] This is, in essence, interest resulting of a debt obligation held for investment by an identifiably foreign person and it is aimed to assure:

1. That the exemption is enjoyed only by actual foreign investors; and

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[9] *Id.*
[10] I.R.C § 871(i).
[11] Pub.L. 98-369, 98 Stat. 494.
[12] I.R.C. § 871(h)(2) (defining *portfolio interest*).

2. That the relationship between the borrower and the lender truly is a portfolio interest and not product of an active business.[13]

Almost any kind of obligation by debt (bonds, notes and even properly recorded debt on open account that is unrelated to business) can qualify to be tax exempted. Naturally, temptation arises for the entrepreneurial and logical individuals, who will try to get around it by presenting their U.S. assets as passive investment instruments.

There are a few exceptions with the purpose of creating limitations to prevent these situations such as the ten (10) percent shareholder limitation, which excludes any interest received by a "10 percent shareholder"[14] of the debtor[15] to prevent tax evasion paid by a corporation to its owners and substantial equity holders. Without this limitation, the tax exemption of a portfolio interest would be an open door for foreign investors to escape U.S. taxation.

Another important exception is that interest received by a bank "on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its trade or business"[16] is not exempt portfolio interest. Naturally, the nature of this loan makes it look more like a business transaction than a passive investment. However, Professor Isenbergh noted that foreign banks can receive exempt portfolio interest on *bona fide* passive investments, such as corporate bonds and U.S. Treasure debt. Also, he suggested that income tax treaties may shield some interest received by foreign banks that do not qualify as exempt portfolio interest.

It should be noted, by this point, that the U.S. tax regime shields only passive investment and excludes any investment that is, in its essence, a business transaction. Thus the reason why sales of real estate cannot be exempt from U.S. taxation, for its essence is more of a business transaction than that of a passive investment.

IV. REASONING AND ANALYSIS OF THE PORTFOLIO INTEREST TAX EXEMPTION

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[13] *Id.*

[14] *Id.* at §871(h)(3)(b). (The term ``10-percent shareholder'' means (i) in the case of an obligation issued by a corporation, any person who owns 10 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote, or (ii) in the case of an obligation issued by a partnership, any person who owns 10 percent or more of the capital or profits interest in such partnership.

[15] *Id.* at §871(h)(3).

[16] *Id.* at §881(c)(3)(a)

Following Professor Isenbergh's reasoning, and his statement asserting that the United States transformed from the biggest exporter to the biggest importer in the world, it is clear that the reasoning for portfolio interest to be tax exempted is that of creating equilibrium between the collection of tax revenues and the stimulation of foreign investment. In other words, the United States taxation regime is designed to appeal to foreign investors by offering tax exemptions on their passive investments and, therefore, trading off some of the collecting tax revenue concern for a higher rate of foreign investment. This reasoning was ratified in the ruling of *Central de Gas de Chihuahua v. Comm'r*,[17] which was a case of a Mexican corporation in the United States that realized transportation of petroleum from different sectors of the U.S. to the border of Mexico. Central de Gas rented a fleet of tractors and trailers to another Mexican corporation, Hidro Gas de Juárez, S.A. Problems arose when Hidro defaulted on its obligation to pay rent to Central de Gas, which was due by the end of the fiscal year of 1990, and the Mexican corporation had incorrectly deducted thirty (30) percent off its Federal income tax return.

Regarding this aspect, the Judge asserted the following:

> Petitioner did not file a Federal income tax return for 1990. Respondent, acting under section 482, allocated to petitioner the amount of $2,320,800 as the fair rental value of the equipment for 1990 (which the parties now agree should be $1,125,000) and determined that petitioner was liable for the 30-percent tax imposed by section 881 on that amount, which is the primary position respondent asserts herein. Respondent also asserted in the deficiency notice and asserts herein, as an alternative position in the event that we should grant petitioner's motion, i.e., hold that the section 881 tax does not apply, that petitioner is liable for tax under section 882 on income effectively connected with the conduct of trade or business within the United States.[18]

This particular case is important since in the listing of tax exempted passive investments of a portfolio interest, the concept of "rents"[19] happens to be among the very first items in the list. The ruling of this case, however, was ultimately based on the fact that the foreign Corporation (Chihuaha) rented equipment to another foreign corporation to transfer petroleum to the border of Mexico, that is, to be used within the United States. The Court unequivocally determined that, in this particular case, the rents in question

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[17] Central de Gas de Chihuahua v. Comm'r, 102 T.C. 515 (1994).
[18] *Id.* at 516.
[19] I.R.C. § 871(a)(1).

constituted part of a trade or business transaction within the United States. In conclusion, two foreign corporations that are carrying out any type of business or trade, are not tax exempt in the United States as to portfolio interest, because these limitations and restrictions are precisely what the aforementioned provisions are for.

In *Commissioner v. Wodehouse*[20], the Court ruled that sums received for the use of copyrights by a nonresident foreign author, who is not engaged in trade or business within United States and who does not have an office or place of business therein, are accounted in calculating the gross income for federal tax purposes.[21]

More specifically, the Court stated:

> Rentals and royalties paid for the use of or for the privilege of using patents, copyrights, and other like property in the United States have long been taxed to nonresident aliens and for many years at least a part of the tax has been withheld at the source of the income, and therefore this type of income would not be exempted from taxation in 1938 or 1941, in absence of clear and positive legislative determination to change the established procedure….Where nonresident alien author not engaged in trade or business in United States and not having an office or place of business therein sold the exclusive serial rights in stories to domestic magazine publisher which agreed to obtain copyright and after publication to reassign all rights to author except American serial rights, lump-sum payments made in advance to author in 1938 and 1941 were not exempt from income tax as proceeds from sale of personal property but were taxable as "royalties" under statute imposing tax on income received by nonresident aliens as fixed or determinable annual or periodical gains, profits, and income.[22]

The facts of *Wodehouse*[23] are fairly simple. A foreign author sold the right to serialize a novel to an America magazine publisher for a lump sum price. The I.R.S. claimed that even if it was a single payment, it was nonetheless fixed or determinable income subject to the flat rate tax. The Court then ruled in favor of the I.R.S. insofar it solved that in the transfer process of said serial rights Wodehouse retained so many other rights regarding the property that there had been no sale to begin with. Since the

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[20] Commissioner v. Wodehouse, 337 US 369 (1949).
[21] Revenue Act 1938, 26 U.S.C.A. §§ 119 (2006). *See* also § 211- 212(a).
[22] *Id.*
[23] Commissioner v. Wodehouse, 337 US 369, 377-383 (1949).

ruling of this case in 1939, a sale and a license are considered to be different, not on the form of payment but to the extent of the rights transferred in the underlying property. Professor Isenbergh expressed that "the outcome of *Wodehouse* left opportunities for foreign taxpayers. As long as they transferred substantial and extensive U.S. rights in intangible property, their transactions were [considered to be] sales"[24] regardless of it being transferred with a single payment or subsequent stream of payments for the buyer's use of the property.

The Court in this case dealt with a problem, regarding income originated from or by intangible property. The difference between "sales" and "licenses" of intangible property is not that complicated depending on the circumstances. As illustrated by the Court, "[a] transfer of a copyright forever, lock, stock, and barrel, with no retained right of use, has always been a sale. The nonexclusive permission to use a secret process in exchange for a percentage of the resulting sales has never *not* been a license."[25]

At this point, we can easily infer that the U.S. taxation regime (and the portfolio interest on passive investment exemption) is focused in the capitalization of the United States banks from foreign investors and the consequent prevention of foreign banks from gaining a competitive advantage over U.S. banks. The lower credits are a result of less foreign taxes being paid by U.S. taxpayers on their foreign source income.

In general, low or zero withholding tax rates are usually designed to attract foreign individuals and corporations to invest through the tax haven, rather than to provide a tax benefit for their own residents, although many tax haven countries have low tax rates in an effort to attract real productive investment into the country.[26]

Margaret P. Lewis, an official working for the I.R.S. at the time of the enactment, published a good analysis and study of the effects and the reasoning for the Deficit Reduction Act of 1984. In reference to the Act and its repercussions, Mrs. Lewis expressed the following statement:

> Almost 70 percent of the increase in U.S. source income paid to foreign persons was accounted for by interest payments. The Deficit Reduction Act of 1984, which became effective on July 18, 1984, exempted most types of interest payments to foreigners from U.S. tax withholding. Not all of this increase can be attributed to the enactment of this legislation, however, since only interest paid on obligations issued after July 18, 1984, was entitled to this exemption. During 1984 high U.S. interest rates helped make investment in the

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[24] ISENBERGH *supra*, note 1 at 19.
[25] ISENBERGH *supra*, note 1 at 95.
[26] MARGARET P. LEWIS, FOREIGN RECIPIENTS OF U.S. INCOME, AND TAX WITHHELD 61-70 (1984).

> United States more attractive to foreign investors who thus helped finance an expanding U.S. economy. The growing U.S. economy also attracted foreign investment as the dollar appreciated against major currencies. Moreover, the large U.S. trade deficits put "strong dollars" into the hands of foreigners who in turn invested them in the United States.
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> High U.S. interest rates, a growing U.S. economy and enactment of the Deficit Reduction Act of 1984, which exempted most types of interest from tax withholding, all contributed to a 57 percent rise in U.S. source income paid to foreign persons in 1984. Interest remained the most common type of income, rising to 59 percent of total income even though it only ac-counted for 21 percent of tax withheld. Foreign corporations remained- the biggest recipients of U.S. source income, receiving 68 percent of all income paid in 1984. Individuals received only 7 percent of income yet accounted for 15 percent of tax withheld. This was because individuals received more dividend income (which is rarely tax-exempt) than interest or any other income type.[27]

Upon consideration and analysis of the previously discussed jurisprudence, as well as the opinions and doctrines presented by Professor Isenbergh and the study presented by Mrs. Lewis, it is clear that the reasoning behind the enactment of these exemptions came as a result of a macroeconomic growth in the United States which intended to keep growing by making investment more appealing for foreign citizens with less strong currency. A glimpse of macroeconomic models and theories could reasonably explain the intention of the enactment of these exemptions.

For instance, the simplest Keynesian model of macroeconomic activity is illustrated by the following formula: $Y = C + I + G + Nx$. In this formula Y represents the total output (or Gross domestic Product) of a certain economy, C represents the general consumption of goods, I represents private sector investment, G represents government expenditure and Nx (Net exports) represents the difference between exports and imports.[28]

The enactment of the tax exemptions could be explained by asserting that the U.S. tax regime was aiming for a substantial increase in the private sector investment (i.e. "*I*") by making foreign citizens feel attracted by the high interest rates that their investments would gain in the U.S. without having to pay taxes. This would result in a substantial increase in their total

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[27] *Id.* at 70.
[28] N. GREGORY MANKIW, MACROECONOMICS 25-33 (Worth Publishers 6th ed. 2007).

output (i.e. "*Y*") and, consequently, a substantial and sustained economic growth of the United States economy.

For these reasons, it is my opinion that the reasoning behind the *portfolio interest* tax exemption was originally enacted to attract substantial investment from other economies, by enticing foreign citizens to invest in a promising and growing economy with interest rates that would derive higher income and be tax exempted in contrast to investing in their own economy. Finally, taking a look at our hypothetical balance of concerns, it seems that there is indeed a tradeoff between collecting tax revenues and stimulating foreign investment, but that this tradeoff would not result in a significant loss of tax collecting revenues, at least in the long run. That is, despite of the increase in the total output (G.D.P.), the substantial increase in private sector investing derived from foreign investors would compensate for it. After all, the higher the increase in the Gross Domestic Product of this economy, the greater the incomes of the labor sector will be and thus the tax collecting revenue would be satisfied with higher amounts of taxable incomes.

BIOPIRACY: IS THERE A NEED FOR A MORE EXTENSIVE DEFINITION OF "NOVELTY" WITHIN THE CONTEXT OF US PATENT LAWS?

NOTE

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I. INTRODUCTION

A patent is the grant of a property right to the inventor of an invention, which is issued by the United States Patent and Trademark Office ("the US PTO").[1] The right conferred by the patent grant is, in the language of the statute and of the grant itself, "the right to exclude others from making, using, offering for sale, or selling the invention in the United States or importing the invention into the United States."[2] What is granted is not the right to make, use, offer for sale, sell or import, but the right to exclude others from making, using, offering for sale, selling or importing the invention.

Consequently, U.S. patent legislation legally grants a monopoly to inventors. Nonetheless, the term "invention" leaves space for lawfully taking and patenting knowledge from undeveloped countries outside of the United States. This shortfall is mainly due to the meaning of "novelty" under United States ("U.S.") patent legislation.

Bioprospecting is generally defined as the search for useful organic compounds in nature, commonly involving the collection and examination of biological samples (such as plants, animals, microorganisms, etc.) for sources

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[1] *See* http://www.uspto.gov/patents/index.jsp.

[2] Patent Act, 35 U.S.C. § 154(a)(1) (2011).

of genetic or biochemical resources.[3] This search, which is sometimes conducted with the "assistance" and "resources" of undeveloped countries, is intended to conclude with the grant of an exclusive patent, without compensation to the source-country of knowledge.

Our objective is to discuss the importance of expanding the meaning of "novelty" within the context of U.S. patent legislation and to further continue efforts towards developing better means to share the benefits of patents with source-countries of knowledge.

II. PATENTS FRAMEWORK AND LAWS

The Constitution of the United States of America gives Congress the power to enact laws relating to patents. In § 8 of Article I, the Constitution declares that the "Congress shall have the [p]ower . . . . [t]o promote the [p]rogress of [s]cience and useful [a]rts by securing for limited [t]imes to [a]uthors and [i]nventors the exclusive [r]ight to their respective [w]ritings and [d]iscoveries."[4]

Under this power, Congress enacted the first patent law in 1790 and has, from time to time, enacted other laws relating to patents. These patent laws underwent a general revision that came into effect on 1953, and is codified as Patent Act in Title 35 of the United States Code.[5]

Three sections of the Patent Act plainly enumerate the elements of patentability: [1] novelty and [2] utility, in § 101[6] and [3] non-obviousness in § 103[7]. Novelty is further defined in § 102[8] within the context of exclusions to patentability.

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[3] Montana State University http://serc.carleton.edu/microbelife/topics/bioprospecting. *See also* "bioprospecting," Oxford Dictionaries. April 2010. Oxford University Press. 6 October 2011 <http://oxforddictionaries.com/definition/bioprospecting<.

[4] U.S. Const. art. I, § 8.

[5] Additionally, on November 29, 1999, Congress enacted the American Inventors Protection Act of 1999 (AIPA), which further revised the patent laws. *See* Public Law 106-113, 113 Stat. 1501 (1999).

[6] 35 U.S.C. § 101 (2011). – Inventions patentable: Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefore, subject to the conditions and requirements of this title.

[7] 35 U.S.C. § 103 (2011). (Conditions for patentability; non-obvious subject matter).

[8] 35 U.S.C. § 102 (2001). – Conditions for patentability; novelty and loss of right to patent: A person shall be entitled to a patent unless—
(a) the invention was known or used by others in this country, or patented or described in a printed publication in this or a foreign country, before the invention thereof by the applicant for patent, or
(b) the invention was patented or described in a printed publication in this or a foreign country or in public use or on sale in this country, more than one year prior to the date of the application for patent in the United States, or

A. Novelty

In simple words, "novelty" is one of the doors that must be opened for a person to be entitled to a patent. If the invention is known or used by others in the United States of America ("U.S.A."), or patented or described in a printed publication anywhere, it is not entitled to a U.S. patent grant.

Accordingly, under U.S. patent provisions; this *geographical constraint* could preclude a patent from being issued on an invention. Thus, it leaves space for knowledge from other countries that not been published in printed media to be patented under U.S. patent laws.

1. Novelty and Patents in Foreign Countries

The U.S. geographical constraint contrasts with other foreign patent legislation. For instance, the European Patent Convention ("E.P.C.") considers also the "novelty" and "utility" elements for patentability. However, it differs from the U.S. patent laws within the framework of a provision that describes "state of the art" as "everything made available to the public by means of a written or oral description, by use, or in any other way, before the date of

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(c) he has abandoned the invention, or
(d) the invention was first patented or caused to be patented, or was the subject of an inventor's certificate, by the applicant or his legal representatives or assigns in a foreign country prior to the date of the application for patent in this country on an application for patent or inventor's certificate filed more than twelve months before the filing of the application in the United States, or
(e) the invention was described in
(1) an application for patent, published under section 122 (b), by another filed in the United States before the invention by the applicant for patent or
(2) a patent granted on an application for patent by another filed in the United States before the invention by the applicant for patent, except that an international application filed under the treaty defined in section 351 (a) shall have the effects for the purposes of this subsection of an application filed in the United States only if the international application designated the United States and was published under Article 21(2) of such treaty in the English language; [1] or
(f) he did not himself invent the subject matter sought to be patented, or
(g)
(1) during the course of an interference conducted under section 135 or section 291, another inventor involved therein establishes, to the extent permitted in section 104, that before such person's invention thereof the invention was made by such other inventor and not abandoned, suppressed, or concealed, or
(2) before such person's invention thereof, the invention was made in this country by another inventor who had not abandoned, suppressed, or concealed it. In determining priority of invention under this subsection, there shall be considered not only the respective dates of conception and reduction to practice of the invention, but also the reasonable diligence of one who was first to conceive and last to reduce to practice, from a time prior to conception by the other.

filing of the European patent application."[9] This means that under the E.P.C. there is no geographical limitation as to the availability of prior knowledge (or "art"); hence, "prior art or knowledge" anywhere – published or not – precludes patentability because of the absence of "novelty". As a result, "novelty" is a term reserved for true unavailability of knowledge or art.

Another example is the Japan Patent Law which also requires "novelty" and "utility" for patentability and excludes geographical limitations to the availability of prior knowledge (or "art").[10] Similar to the E.P.C., the Japan Patent Law ("J.P.L.") considers "prior art or knowledge" anywhere – published or not – as deterrence to patentability because of the absence of "novelty".

So, based on the different definitions of "novelty", patents granted by the US PTO can lawfully benefit from prior knowledge elsewhere (outside the United States, if not made public in printed media), while the rest of the countries considers as a limitation to patentability any "prior art or knowledge" available, within or outside their countries. By these means, the U.S. statutory definition of novelty certainly puts US patents applications in a better position than those applications in foreign countries.

III. BIOPROSPECTING VERSUS BIOPIRACY

Bioprospecting begins when firms from developed countries, such as multinational corporations based in the United States, interact with aboriginal or indigenous cultures in developing countries. The firms learn the "traditional knowledge" of these cultures, especially as that knowledge is applied to biotechnology.[11]

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[9] European Patent Convention, art. 52(1), Oct. 5, 1973, 1075 U.N.T.S. 199. European patents shall be granted for any inventions, in all fields of technology, provided that they are new, involve an inventive step and are susceptible of industrial application. An invention shall be considered to be new if it does not form part of the state of the art, *id.* at Art.54(1). The state of the art shall be held to comprise everything made available to the public by means of a written or oral description, by use, or in any other way, before the date of filing of the European patent application, *id.* at Art.54(2).

[10] Tokkyohō [Tokkyohō] [Pat. L.] 1959 § 29, no. 1 (Japan). – Conditions for Patentability: An inventor of an invention that is industrially applicable may be entitled to obtain a patent for the said invention, except if one of the following applies prior to the filing of the patent application; (i) inventions that were publicly known in Japan or a foreign country, (ii) inventions that were publicly worked in Japan or a foreign country, or (iii) inventions that were described in a distributed publication, or inventions that were made publicly available through an electric telecommunication line in Japan or a foreign country. (*See* http://www.wipo.int/clea/docs_new/pdf/en/jp/jp006en.pdf for a non-official translation of the law. At October 29, 2011 no official translation exist).

[11] *See* Jonathan B. Warner, *Using Global Themes to Reframe the Bioprospecting Debate*, 13, IND. J. GLOBAL LEG. STUD. 645 (2006).

Biopiracy, on the other hand, has emerged as a term to describe the ways that firms from the developed world claim ownership of, or otherwise take unfair advantage of, the genetic resources and traditional knowledge and technologies of developing countries. This knowledge is then appropriated by that firm under the developed country's intellectual property laws (generally by means of patents), to the exclusion of the indigenous cultures from which that knowledge originated, without compensation to the indigenous groups who originally developed such knowledge.

It can be fairly expected that, under the generous provisions of the US patent laws (where "novelty knowledge" can be easily found outside the U.S.), U.S. firms would be searching for traditional knowledge with the "assistance" and "resources" of undeveloped countries, with the ultimate purpose of obtaining a U.S. patent. Nevertheless, the difference between "bioprospecting" and "biopiracy" rests in the willingness of the firms learning the "traditional knowledge" to not only conserve and promote sustainability of biological diversity but also to equitably share the benefits of bioprospecting.

A. Traditional Knowledge (T.K.)

The World Intellectual Property Organization ("W.I.P.O.") defines T.K. as a form of knowledge which has a traditional link with a certain community; it is knowledge which is developed, sustained and passed on within a traditional community, and is passed between generations, sometimes through specific customary systems of knowledge transmission. It is the relationship with the community that makes it "traditional" since is being created every day and evolves as individuals and communities respond to the challenges posed by their social environment.[12]

1. 1992 Convention on Biological Diversity ("C.B.D.")

Recently, international attention has turned to intellectual property laws to preserve, protect, and promote T.K. Accordingly, in 1992, the C.B.D. recognized the value of T.K. in protecting species, ecosystems and landscapes; incorporating language regulating access to it and its use. It soon became apparent that implementing these provisions would require that

[12]W.I.P.O. Booklet No. 2 Intellectual Property and Traditional Knowledge. http://www.google.com/search?client=safari&rls=en&q=Intellectual+Property+and+Traditional+Knowledge&ie=UTF-8&oe=UTF-8 (One of a series of Booklets dealing with intellectual property and genetic resources, traditional knowledge and traditional cultural expressions/folklore).

international intellectual property agreements be revised to accommodate them.

The C.B.D. was drafted in response to shared concerns of international organizations and governments, with the objective of developing strategies for the conservation and sustainable use of biological diversity as well as providing means for equitable sharing of benefits of bioprospecting (i.e., compensating source countries). The treaty set new standards that more than 190 member countries[13] are expected to follow when engaging in bioprospecting. Nonetheless, there is a level of distrust regarding the success potential since C.B.D., although a legal document; is a voluntary treaty among member countries. Therefore, it does not incorporate means to effectively enforce its provisions.

2. The case of INBio - Costa Rica

An example of the standard of conduct in dealing with biological diversity of undeveloped countries is the biodiversity prospecting agreement between Merck Pharmaceutical Ltd. and the National Biodiversity Institute of Costa Rica ("INBio"), a non-profit, public interest organization established by

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[13] C.B.D. member countries: (Andorra, Holy See, Iraq, Somalia and U.S.A. are not members) Afghanistan, Albania, Algeria, Angola, Antigua and Barbuda, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahamas, Bahrain, Bangladesh, Barbados, Belarus, Belgium, Belize, Benin, Bhutan, Bolivia, Bosnia and Herzegovina, Botswana, Brazil, Brunei Darussalam, Bulgaria, Burkina Faso, Burundi, Cambodia, Cameroon, Canada, Cape Verde, Central African Republic, Chad, Chile, China, Colombia, Comoros, Congo, Cook Islands, Costa Rica, Côte d'Ivoire, Croatia, Cuba, Cyprus, Czech Republic, Democratic People's Republic of Korea, Democratic Republic of the Congo, Denmark, Djibouti, Dominica, Dominican Republic, Ecuador, Egypt, El Salvador, Equatorial Guinea, Eritrea, Estonia, Ethiopia, European Community, Federated States of Micronesia, Fiji, Finland, France, Gabon, Gambia, Georgia, Germany, Ghana, Greece, Grenada, Guatemala, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, Hungary, Iceland, India, Indonesia, Ireland, Islamic Republic of Iran, Israel, Italy, Jamaica, Japan, Jordan, Kazakhstan, Kenya, Kiribati, Kuwait, Kyrgyzstan, Lao People's Democratic Republic, Latvia, Lebanon, Lesotho, Liberia, Libyan Arab Jamahiriya, Liechtenstein, Lithuania, Luxembourg, Madagascar, Malawi, Malaysia, Maldives, Mali, Malta, Marshall Islands, Mauritania, Mauritius, Mexico, Monaco, Mongolia, Montenegro, Morocco, Mozambique, Myanmar, Namibia, Nauru, Nepal, Netherlands, New Zealand, Nicaragua, Niger, Nigeria, Niue, Norway, Oman, Pakistan, Palau, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Poland, Portugal, Qatar, Republic of Korea, Republic of Moldova, Romania, Russian Federation, Rwanda, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, San Marino, Sao Tome and Principe, Saudi Arabia, Senegal, Serbia, Seychelles, Sierra Leone, Singapore, Slovakia, Slovenia, Solomon Islands, South Africa, Spain, Sri Lanka, Sudan, Suriname, Swaziland, Sweden, Switzerland, Syrian Arab Republic, Tajikistan, Thailand, The former Yugoslav Republic of Macedonia, Timor-Leste, Togo, Tonga, Trinidad and Tobago, Tunisia, Turkey, Turkmenistan, Tuvalu, Uganda, Ukraine, United Arab Emirates, United Kingdom of Great Britain and Northern Ireland, United Republic of Tanzania, Uruguay, Uzbekistan, Vanuatu, Venezuela, Vietnam, Yemen, Zambia, Zimbabwe. *See* http://www.cbd.int/information/parties.shtml.

the Costa Rican government. In pursuing the search for wild species with medicinal, veterinarian, or agricultural potential, in 1991 INBio granted Merck the right to evaluate commercial prospects of a limited number of plant, insect, and microbial samples collected in Costa Rica's eleven (11) conservation areas. In return, Merck paid INBio $1 million over two years, and provided equipment for processing samples and scientific training.[14]

By means of such bioprospecting agreements like this that have been negotiated since then, Costa Rica is now earning revenues from resources for which it previously received nothing (because there was no market at all). In addition, besides sharing the economic benefits of the intellectual property rights, Merck contributed to the sustainability and development of the Costa Rican economy by providing technical training and equipment to its people.

IV. CONCLUSION

Is there a need for a more extensive definition of "novelty" within the context of the U.S. patent legislation? Or, would it be enough to pursue more effective ways to enforce C.B.D. internationally?

Maybe, expanding the meaning of "novelty" is the easiest way to deter biopiracy, and pursue the fair use of TK and biodiversity of undeveloped countries. However, the United States must have had strong reasons for not yet ratifying the C.B.D. (which had been ratified by countries that deal the "more extensive definition"). In my opinion, the reasons relate to the enormous economic interest contained in the statutory definition of "novelty".

This being said, at this moment in history what U.S. firms must strive for is to not fall in biopiracy conduct but instead to assume a leadership role within the true meaning of bioprospecting. The ultimate incentives of the firms learning the "traditional knowledge" should not be a patent grant *per se*. It should entail the conservation and promotion of sustainable biological diversity, as well as the equitably distribution of the benefits of bioprospecting.

In any case, we should not forget that the First Amendment of the U.S. Constitution[15] ensures access to information, by fostering creativity and freedom of expression; inevitably resulting in technological and scientific advancement. Bioprospecting must be construed as means of a contribution to the sharing of such information (including T.K.).

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[14] Elissa Blum, *Making Biodiversity Profitable: A Case Study of the Merck/INBio Agreement*, 35 ENVIRONMENT 4, 40 (1993).

[15] "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances." U.S. Const. amend. I.