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First Circuit Declares Puerto Rico Alternative Minimum Tax Unconstitutional

On August 24, 2016, the U.S. Court of Appeals for the First Circuit in *Wal-Mart Puerto Rico, Inc. v. Juan C. Zaragoza-Gomez* held that Puerto Rico's corporate alternative minimum tax (the "AMT") violated the dormant Commerce Clause and affirmed the district court's injunction against enforcement of the AMT against Wal-Mart Puerto Rico, Inc. ("Wal-Mart PR"). The AMT is a tax equal to the amount (if any) by which a corporate taxpayer's tentative minimum tax exceeds its regular tax on income. The tentative minimum tax is calculated, in part, from the value of goods and services sold or otherwise provided to a corporate taxpayer by a related entity or home office located outside of Puerto Rico. As amended in May 2015 to increase its rate on large taxpayers, Wal-Mart PR alleged that the AMT, if enforced, would have applied at its highest rate only to Wal-Mart PR and would have made Wal-Mart PR's total tax liability for 2016 132% of its total annual income. Wal-Mart PR estimated that in future years it would have paid \$40 million per year as a result of the AMT and that its annual effective tax rate would have been over 300%. In December 2015, Wal-Mart PR sought an injunction against the continued enforcement of the AMT against it and a declaration that the AMT was unlawful under the dormant Commerce Clause (among other reasons). In March, the U.S. District Court for the District of Puerto Rico sided with Wal-Mart PR and permanently enjoined and declared invalid, under both federal constitutional and statutory law, the AMT.

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As a threshold matter, the First Circuit held that the Butler Act and the doctrine of comity did not deprive the federal courts of jurisdiction over Wal-Mart PR's suit in the absence of a plain, speedy and efficient remedy in Puerto Rico. In light of recent legislation in Puerto Rico that placed an annual cap on certain judgments and prioritized other debts over tax refunds, the First Circuit concluded that Wal-Mart PR lacked a plain, speedy and efficient remedy in the Puerto Rico courts. Reaching the merits, the First Circuit held that the AMT as amended is facially discriminatory and does not meet the heightened level of scrutiny required to survive under the dormant Commerce Clause. Because the AMT (as applied to Wal-Mart) applies only to inter-jurisdictional transfers within a corporate family, and because narrower alternatives exist that would address Puerto Rico's profit-shifting concerns, the First Circuit held the AMT to be unconstitutional.

The First Circuit's *Wal-Mart* decision is significant on several counts in Puerto Rico's present circumstances. It deprives Puerto Rico of a significant source of revenue. It also opens federal courts to challenges to the validity of other taxes in Puerto Rico applicable to non-Puerto Rican companies, such as the Puerto Rican excise tax applicable to related-party purchasers of goods manufactured in Puerto Rico. Please contact one of the authors listed above or your Ropes & Gray tax advisor for further information.