



May 13, 2013

Tax Alert 2013-02

SUMMARY OF THE PROPOSED "REDISTRIBUTION AND ADJUSTMENT OF THE TAX RESPONSIBILITY ACT"

The Puerto Rico Legislature is currently considering concurrent Bills (HB 1073 and SB 544), which, if approved as filed, will significantly alter the current Puerto Rico tax structure, particularly the Sales and Use Tax provisions of the Puerto Rico Internal Revenue Code of 2011, as amended (the "2011 Code"). The **proposed** principal changes are summarized as follows:

Changes Applicable to Corporations

- The surtax exemption of \$750,000 applicable to corporations will be reduced to a maximum of \$250,000. The exemption will be gradually reduced based on the corporation's net income subject to normal tax and will cap off at \$25,000 for corporations with net income subject to normal tax of \$2 million and above. The deduction will have to be distributed among members of a controlled group.
- Alternative Minimum Tax (AMT) – The AMT calculation is modified. The AMT for taxpayers with gross sales of at least \$10 million will be 20% of the alternative minimum taxable income or a set percentage of the purchases of personal property from related persons, whichever is higher. The general rule is 2%, but different percentages are applicable to other types of personal property. The definition of personal property is modified to include articles such as spirits, vehicles, gasoline and petroleum.
- Other AMT Changes – the definition of a related person is modified to include purchases to home offices (for branches doing business in PR). Property acquired from a related person doing business in PR is not included in this calculation.
- Other AMT Changes – the AMT adjustment for expenses deducted related to services performed outside PR is eliminated effective January 1, 2013. However, a new tax of 20% is imposed on these expenses.
- Other AMT Changes – the Net Operating Losses deduction for AMT will be limited to 80% of the taxpayers' alternative minimum taxable income.
- Net Operating Loss deduction carry forward for regular taxes will be limited to 90%.
- Net Operating Losses generated after December 31, 2004 and before January 1, 2013 will have a carry forward period of 12 years. Net Operating Losses incurred after December 31, 2012 will have a carry forward period of 10 years.

Changes Applicable to Pass-Through Entities

- Partnerships, Special Partnerships and Corporations of Individuals – Payments made to partners, members or shareholders holding a 50% ownership interest on such entity, will not be deductible if such payments are not subject to tax in the year paid or incurred.

Changes Applicable to Individuals

- Special New Tax On Self-Employed Individuals – a 2% tax on the gross income in excess of \$200,000 of self-employed individuals. A deduction for the cost of sales will be allowed.
- The mortgage interest deduction will be limited to \$35,000. The 30% gross income limitation remains unchanged.

Generally Applicable Changes

- Tax Credit Moratorium – a previously existing limitation on tax credits is reactivated. If you have purchased tax credits or are planning to do so, please contact us to confirm if your credit is partially or fully subject to this moratorium.

Sales and Use Tax Changes

- The definition of taxable services is modified to include designated services (those provided by Attorneys, CPAs, Engineers, Architects, etc.), vehicle leasing, services rendered to a person engaged in a trade or business (also known as business to business) and bank charges.
- Elimination of the wholesalers' exemption certificate. A sales and use tax credit for items acquired by wholesalers is established, but limited to 50% of the wholesaler's tax liability.
- The exemption for commercial real estate rental is eliminated.
- The exemption for the services provided by day care centers is limited to enrollment and monthly payments.
- The exemption on items purchased by Superior Education Institution is eliminated.
- The exemption on articles, machinery and equipment acquired by health services entities is eliminated.
- The exemption on items acquired during the back to school period is generally limited to the acquisition of uniforms, books, and certain materials.
- The municipal portion of the sales and use taxes is decreased from 1.5% to 1%, bringing the total sales and use tax to 6.5%.
- The Savings and Loan Association Act (Cooperatives) is amended to eliminate the sales and use tax exemption that these entities enjoyed.

Other Miscellaneous Changes

- Amends the Insurance Code of Puerto Rico to impose all insurers doing business in PR a 1% tax on premiums.

Please note that these are proposed changes and are subject to change as the Bill goes through the legislative process. If the Bill is approved as filed, all these changes would be effective on January 1, 2013, except for the sales and use tax changes, which would be effective on July 1, 2013. Feel free to contact us to discuss the possible impact these **proposed changes** may have on your business.

* * *

Please contact Rafael A. Arce, JD, CPA, MST, Senior Tax Manager at 787-725-1600 or at rarce@vgmmcpa.com, or any of our partners should you have any questions or comments or if you need additional information regarding this matter. This Tax Alert has been prepared for informative purposes and it is not intended to provide and does not constitute tax advice. Please contact us at 787-725-1600 or at fsosa@vgmmcpa.com if you would like us to add/delete you from our mailing list.

Follow us in Twitter, Facebook and Linked-in if you wish to be informed of the latest developments in taxation, accounting, and other financial matters. You can access our pages by clicking in the icons below.

