



### Tax Alert 2013-03

#### GOVERNOR SIGNS “REDISTRIBUTION AND ADJUSTMENT OF THE TAX RESPONSIBILITY ACT”

On June 30, 2013, the Governor of the Commonwealth of Puerto Rico signed the Redistribution and Adjustment of the Tax Responsibility Act (RATRA). Below is a summary of the most important provisions of the RATRA.

- Amends the Insurance Code of Puerto Rico to impose all insurers doing business in PR a 1% tax on premiums earned after June 30, 2013. This special tax will not apply to premiums earned from Medicare Advantage, Medicaid, Mi Salud, Inc., or annuities.
- 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, when applicable. This new tax cannot be deducted and is paid with the tax return.
- The mortgage interest deduction applicable to individual filers will be limited to \$35,000 per tax payer (not per residence). The 30% gross income limitation remains unchanged.
- Alternative Basic Tax (ABT) for individuals is increased. New tax rates are based on income subject to the ABT as follows: From \$150,000 to \$250,000 the tax rate is 10%; from \$250,001 to \$500,000 the tax rate is 15%; and income in excess of \$500,000 will be taxed at 24%.
- Maximum corporate tax rate is increased from 30% to 39%.
- Taxpayers that chose to be taxed under Option 94, a provision enacted under the Puerto Rico Internal Revenue Code of 2011 (the “2011 Code”), as amended, which irrevocably allowed all taxpayers to determine their tax liability under the old 1994 Puerto Rico Internal Revenue Code, as amended, for 5 tax years effective the tax year 2011, can elect to be taxed under the 2011 Code for tax year 2013 and thereafter. Once this election is selected, it is irrevocable.
- Normal corporate tax rate remains unchanged at 20%. The surtax is changed to a progressive tax structure as follows:

No more than, \$75,000, 5%

\$75,001 - \$125,000, \$3,750 + 15% of the excess of \$75,000

\$125,001 - \$175,000, \$11,250 + 16% of the excess of \$125,000

\$175,001 - \$225,000, \$19,250 + 17% of the excess of \$175,000

\$225,001 - \$275,000, \$27,750 + 18% of the excess of \$225,000

In excess of \$275,000, \$36,750 + 19% of the excess of \$275,000

- Surtax exemption is decreased from \$750,000 to \$25,000.

- Net Operating Losses are limited to 90% of corporation's taxable income. Carryover periods are also changed as follows:

Up to 2004 – Carryover of 7 years

From 2005 to 2012 – Carryover of 12 years

2013 and thereafter – Carryover of 10 years

- Certain expenses will be partially or fully disallowed in computing a company's taxable income: (1) The Gross Income Additional Tax (later explained) will not be allowed as a deduction in computing a company's taxable income; (2) 51% of all payments made to an affiliated entity (including a Home Office) if these payments are not subject to tax in Puerto Rico.

This provision does not apply to entities operating under a tax exemption grant. The Secretary of the Treasury may exempt taxpayers from this requirement under certain circumstances.

- 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.

#### **Alternative Minimum Tax**

- Alternative Minimum Tax (AMT) rate for corporations is increased from 20% to 30%, adjustment of excess book income over taxable income is increased from 50% to 60%.
- AMT net operating loss deduction limitation is increased from 90% to 80%.
- 20% tax on payments made to affiliated entities when these payments are not subject to tax in Puerto Rico. This tax also applies to payments made by a branch operating in PR to a home office and is part of a corporation's AMT calculation. This tax does not apply to entities with a tax exemption grant or bona fide farming entities.
- The calculation of the corporate AMT will also include an additional tax of 2% on purchases of personal property made from related persons (including a home office). Tax rate will be less than 2% on the purchase of certain property:
  - ✓ Alcoholic beverages (.5%);
  - ✓ Oil and oil derivatives (.5%);
  - ✓ Motor vehicles (1.5%).

This additional tax does not apply to entities with gross receipts below \$10 million, purchases of raw materials to be used in manufacturing, or entities with tax exemption grants. The Secretary of the Treasury may reduce this tax (not below .2%) if the taxpayer can prove that the property is purchased from the related party at the same (or similar) price that the related party sells to unrelated parties. The taxpayer will also need to file a transfer pricing study as part of the evaluation process.

Under the new rules the AMT calculation methodology suffered significant changes. Companies now will be required to go through two computations and elect as its AMT payable the higher of the two or the regular tax, whichever is higher.

In the first computation, corporations will add the regular AMT as it was previously calculated under the 2011 Tax Code and add the Gross Income Additional Tax discussed below. In the second calculation, taxpayers must add 20% of the expenses incurred or paid for services rendered by a related person, plus 2% of the value of purchases of personal property made to a related person (only applicable if the taxpayer exceeded \$10 million in gross receipts), plus the Gross Income Additional tax.

### **Gross Income Additional Tax**

- Gross Income Additional Tax (GIAT) – the RATRA imposes a new tax on the gross income of all corporations and pass-through entities. This tax is as follows:

<b><u>If gross income is:</u></b>	<b><u>The tax rate will be:</u></b>
From \$1 million to \$3 million	.20%
In excess of \$3 million to \$300 million	.50%
In excess of \$300 million to \$600 million	.70%
In excess of \$600 million to \$1.5 billion	.80%
In excess of \$1.5 billion	.85%

- The GIAT will be 1% for all financial businesses
- The Secretary of the Treasury may exempt certain entities from this tax if the taxpayer can prove that the GIAT will cause irreparable damage to the taxpayer's finances based on the company's relative low gross margins. The taxpayer will need to file, among other documents, an agreed upon procedures prepared by a Puerto Rico Certified Public Accountant member of the Peer Review Program.
- Gross income definition varies based on industry but it generally means gross sales (without any deduction for cost of good solds).
- This tax will not apply to entities with tax exemption grant, exempt entities under Section 1101.01 of the 2011 Code, bona fide farming entities, health insurance premiums from the Medicare Advantage program, Medicaid, Mi Salud, Inc., annuities, and entities subject to the Effectively Connected Income Rules under Section 1123(f) of the 1994 Puerto Rico Internal Revenue Code, as amended.
- The GIAT will be calculated as part of a corporation's AMT calculation. The GIAT for the year is to be estimated and included as part of the estimated tax payment requirement for all entities.
- The GIAT is also applicable to pass-through entities. The tax is paid by the pass-through entity on behalf of its owners as part of the quarterly estimated tax due on the distributable share of the entity's owners.
- Controlled groups must calculate the GIAT based on the group's aggregate gross receipts.
- This tax is applicable effective for tax years commenced after December 31, 2012.

### **Tax Credit Moratorium**

- 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.
- The Tax Credit Moratorium will be in effect for tax years commencing after December 31, 2012 and prior to January 1, 2016.
- The following tax credits are limited by the moratorium: Housing Infrastructure, Santurce Theater District, Revitalization of Urban Centers, Easement Conservation, and credits for locally manufactured products.
- Manufacturing, Tourism and Film credits are unaffected by this moratorium.
- The PR Treasury Department will not approve the issuance of new credits during the moratorium period.

- Any of the tax credits affected by the moratorium acquired before June 30, 2013, will be limited to 50% of such credit during the moratorium period.

### **Sales and Use Tax**

- The Savings and Loan Association Act (Cooperatives) is amended to eliminate the sales and use tax exemption that these entities enjoyed.
- Operating leases (such as daily rental of vehicles) will be subject to the sales and use tax (SUT).
- Effective December 1, 2013, the municipality portion of the SUT will be reduced from 1.5% to 1%. The Legislature may postpone the applicability of the reduction until February 1, 2014.
- Effective August 1, 2013, the reseller certificate is eliminated. All sales between resellers will be subject to the SUT.
- Every merchant that sells taxable items is required to collect and remit to the PR Treasury Department the SUT. There are two exceptions to this rule: (1) merchants engaged in providing repair services will not be required to collect the SUT. The merchant who received the repair service will be required to self-impose the SUT and remit it to the PR Treasury; (2) merchants engaged in manufacturing may request from the PR Treasury a waiver from the requirement to withhold the SUT when selling taxable items to certain wholesalers.
- A merchant engaged in selling taxable items to entities exempt from the SUT (generally manufacturing entities) may request an Eligible Reseller Certificate exempting them from the payment of the SUT.
- Resellers with a valid Reseller Certificate will be allowed a credit limited to 70% of the SUT paid during the month applicable to the tax liability for said month. The credit will be 100% of the SUT paid during the month, provided that the taxpayer opens a bank account from which the PR Treasury Department will withdraw the SUT funds deposited therein. The Secretary of the Treasury will later issue guidance on this requirement.
- Any unused SUT credit will be carried forward indefinitely until fully used, subject to the 70% limitation explained above.
- These SUT provisions will be effective on August 1, 2013.
- The SUT business to business exemption was amended to exclude certain services. The following business to business services will now be subject to the SUT: bank charges related to account management, debt collection services, security services, cleaning services, laundry services, repair and maintenance services, telecommunication services (services between telecommunication companies is exempt), waste disposal services.
- Repair services will be subject to the use portion of the SUT. This means that the SUT will be self imposed by the recipient of the service and will be required to pay the tax in its monthly SUT return.
- Services provide between members of a controlled group are exempt from the SUT.
- The SUT exemption for Universities and technical colleges and schools is eliminated
- The following articles and services are exempt from the SUT:
  - ✓ Medical equipment, materials and articles used in the diagnostics process purchased by entities with a tax exemption grant under the Hospital Tax Exemption Act. Equipment or materials used in the administrative or commercial operations will be subject to the SUT.
  - ✓ Registration and monthly child care services fees. Any portion of the registration or monthly fee related to educational or recreational services will be subject to the SUT.
  - ✓ Prescription drugs. OTC drugs will be subject to the SUT.

- ✓ School and university textbooks (including all kinds of notebooks) required by a course or class.
  - ✓ School uniforms and certain educational materials during a 2 day period in July and January. The Secretary of the Treasury will issue a communication each year informing the specific days.
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- Effective July 1, all merchants with gross sales in excess of \$100,000 must remit the monthly SUT return and pay the corresponding tax electronically.
  - All the RATRA provisions are effective for taxable years commencing after December 31, 2012, except the provisions related to the SUT, which are effective after June 30, 2013 (SUT applicable to taxable services), and after July 31, 2013 (for the sale of tangible personal property).

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