



January 24, 2014

Audit and Tax Alert 2014–01

Governor Signs Act. No. 163 of December 25, 2013

On December 25, 2013, the Governor of Puerto Rico signed into law Act 163-2013, “Law for Effective Mechanisms for Tax Enforcement.” Among the most significant matters, the Law amends sections of the Municipal License Tax Law, the Municipal Property Tax Law (Law 83-1991, as amended), the General Corporation Law for the Commonwealth of Puerto Rico (Law 164-2009, as amended), and several sections of the 2011 Internal Revenue Code for a New Puerto Rico (the Code) (Law 1-2011, as amended).

Significant amendments brought by the Law include the addition of new requirements for supplemental information accompanying the audited financial statements to be filed with the Municipal Tax, Personal Property Tax, and Income Tax returns, as well as new changes to the requirement of filing a balance sheet with the Puerto Rico Department of State.

This Law became effective upon signature by the Governor, except for the requirements to file supplementary information with audited financial statements which will be effective for tax years beginning after December 31, 2012.

The additional supplementary information must be submitted accompanying the audited financial statements filed to the Department of Treasury, the Municipality, and the Municipal Revenue Collection Center. The supplementary information will be subject to the audit procedures performed by the CPA during the audit of the financial statements of the entity. The Law provides civil and legal penalties to the taxpayer and the CPA if the Secretary determines that the information submitted to the Treasury Department is false and there is a confabulation between the taxpayer and the CPA to provide such false information.

The following is a summary of the new requirements and amendments to the 2011 Internal Revenue Code, provided by Law No. 163. The Law requires the following supplementary information to accompany the audited financial statements filed with:

- The Municipal License Tax Return
 1. Total gross income
 2. A breakdown of other income (if any)
 3. For retailers, total amount of merchandise returns and allowances
 4. For gas stations, number of gallons sold and the amounts for (a) and (b) above
 5. For exempt businesses, a detail of income from exempt and taxable operations, if any

- The Personal Property Tax Return
 1. The amount of inventory for each month of the calendar year
 2. The amount of inventory reserves for each month of the calendar year or tax year, if different
 3. The amount of cash, classified as cash in bank as of January 1st and the amount of cash deposited into a financial institution before January 1st and credited to the bank account after January 1st
 4. In the case of businesses operating under a tax exemption decree, a breakdown of the book value of assets at January 1st not being used in the exempt operations
 5. The amount of inventory adjustments (reserves), if any, for each month of the calendar year, or tax year if different

- The Annual Report to the P.R. Department of State
 1. For all domestic and foreign corporations, the annual report must include an audited balance sheet certified by a CPA with license in Puerto Rico along with the corresponding auditors' report. Not for profit and non-stock corporations and those for profit corporations whose revenues do not exceed \$3,000,000 must file a balance sheet with the annual report. The balance sheet does not need to be certified by a CPA.

- The Income Tax Return (all taxpayers)
 1. Businesses with gross revenues under \$1,000,000 are not required to file financial statements with the corresponding income tax return.
 2. Businesses with gross revenue of more than \$1,000,000 but less than \$3,000,000 may elect to file required supplementary information. If the supplementary information is accompanied to the required financial statements, the business may request a total or partial waiver from the tax withholding requirements for services rendered.
 3. Businesses with gross revenues of \$3,000,000 or more and those electing to file under (2) above, must file the financial statements accompanied with the following supplementary information and statements:
 - a) All withholdings of tax over salaries paid and the corresponding tax deposits were made in accordance with the Code.
 - b) All withholdings of tax on services rendered and the corresponding tax deposits were made in accordance with the Code.
 - c) All tax withheld on payments to non-residents was deposited in accordance with the Code.
 - d) All imposed use tax reported was duly deposited, as required by the Code.
 - e) Sales tax reported was deposited, reduced by any credit, as required by the Code.
 - f) All credits generated from the purchase of tangible personal property acquired for re-sale, the amount of credits used in monthly returns, and the balance at beginning and at end of taxable year of credits available for use are in accordance with the Code.
 - g) Expense accounts underlying the accounting records do not include personal expenses of partners, stockholders, members, owners, employees, or family members. Among the accounts to be analyzed by the CPA are: maintenance, repairs, representation, seminars and training, reimbursements, auto and transportation, travel and other miscellaneous expenses. Any exceptions noted by a CPA must be reported and the corresponding amount and account disclosed. **(Postponed to tax years beginning after March 31, 2013 by the Internal Revenue Administrative Determination No. 13-22).**
 - h) The use tax has been paid on the disposal of tangible personal property at less than cost in exchange for a contract for services or a maintenance contract.
 - i) The amount of salaries reported on Form 499R2/W2PR as well as other payments, reimbursements or compensation to owners, stockholders, partners, or members including payments on their behalf.
 - j) Total salaries paid during the year agree to Form W-3PR. If a calendar year taxpayer, the amount must also be agreed to the quarterly payroll tax returns.
 - k) The expense for services rendered is reconciled to Forms 480.6 filed with the PR Treasury Department in addition to a detail of payments for services under \$500 (not reportable).
 - l) The rent paid is reconciled to Form 480.6 filed with PR Treasury Department.
 - m) A breakdown at end of year is prepared on loans to partners, members, stockholders or if applicable, to members of a controlled group or related entities.
 - n) A business operating under a tax exemption decree is complying with the decree requirements. **(Postponed to tax years beginning after March 31, 2013 by the Internal Revenue Administrative Determination No. 13-22).**

- o) For construction contractors, and for contracts exceeding \$1,000,000:
 - Sales and Use taxes have been paid
 - The accounting method used, and if its use is authorized under the Code- **(Postponed to tax years beginning after March 31, 2013 by the Internal Revenue Administrative Determination No. 13-22).**
 - If the percentage of completion method is used, the percentage of completion of each project has been certified by an engineer – **(Postponed to tax years beginning after March 31, 2013 by the Internal Revenue Administrative Determination No. 13-22).**
 - The retained amount represents the total amount withheld from projects that have not been certified as completed.
- p) Other specific requirements for Hospital Units operating under Law 180 of June 30, 1998, as amended, and for financial institutions. **(Postponed to tax years beginning after March 31, 2013 by the Internal Revenue Administrative Determination No. 13-22).**

- A new section 1063.14 is added to the Code to require the filing of an informative return on forgiveness of debt. Section 1031.01 of the Code is also amended regarding the exclusion from gross income of forgiveness of mortgage debt, requirements, and its tax treatment.
- Section 1033.17 is also amended to clarify the deduction of expenses incurred or paid to a related person or to a Home Office by its Branch in Puerto Rico, and Section 1040.04 as to when these may be claimed as a deduction.
- The Law expands sections of the Code to assess penalties for not filing certain Informative returns, tax returns reconciliation statements, transaction reports, and brokers' declarations.
- The powers of the Secretary of Treasury are increased with regard to tax examinations.
- The Code is amended with respect to certain aspects of closing agreements.
- The Law empowers the Secretary to publish information of taxpayers with past due debts.
- The Law clarifies requirements, duties, rights, and adds sanctions and penalties to the Certified Public Accountants over the supplementary information submitted with the audited financial statements.

The Treasury Department will issue regulations, circular letters, and/or administrative determinations for the interpretation and implementation of this Law.

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