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TAX ALERT 2015-08

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GOVERNOR SIGNS ACT 72-2015 TO AMEND THE PUERTO RICO INTERNAL REVENUE CODE AND ESTABLISH A VALUE ADDED TAX



On May 29, 2015, the Governor of Puerto Rico signed into law Act 72-2015 ("Act 72"), which mainly provides the following:

- » Amends certain provisions of the Puerto Rico Internal Revenue Code of 2011, as amended ("PRIRC");
- » Establishes transitional measures for the migration from the existing Sales and Use Tax ("SUT") towards a Value Added Tax ("VAT"), effective on April 1, 2016; and
- » Creates the Commission for Alternatives to Transform the Consumption Tax ("CATIC", by its Spanish acronym) to evaluate additional tax alternatives to the consumption-based tax system.

This **TAX ALERT** provides a summary of the most significant aspects of Act 72.

INCOME TAXES - CORPORATIONS

The following provisions will be effective for **tax years starting after 12/31/14**.

- **Large taxpayers** – the Act adds a new definition, Large Taxpayers ("LTs"), and establishes specific filing mechanisms for such taxpayers. LTs are defined as those engaged in trade or business in Puerto Rico that meet at least one of the following requirements:
 - Commercial banks, trust companies, private banks;
 - Brokerage houses;
 - Insurance companies;
 - Telecommunication entities; or
 - Entities with volume of business of at least \$50 million in the preceding taxable year.

LTs shall file their income tax return with an office to be established by the Treasury Secretary, or by electronic means, if so required through the issuance of regulations, administrative determinations, circular letters, etc. Returns that do not comply with the required filing mechanism shall be deemed as not filed and subject to the penalties provided in Section 6030.11 of Subtitle F of the PRIRC.

Please contact your account service partner should you have any questions or comments or if you need additional information regarding these matters.

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INCOME TAXES CORPORATIONS (continued)

INCOME TAXES – CORPORATIONS

- **Net operating losses (“NOLs”)** – the NOL carryover deduction is reduced from 90% to 80% of taxable income. In addition, the Act disallows the deduction of all expenses incurred or paid to affiliates not subject to Puerto Rico tax (including a home office) in the computation of NOLs available for carryforward¹.
- **Capital losses** – the capital loss deduction is reduced from 90% to 80% of capital gains. Carryforward losses shall be considered short-term capital losses and shall be deductible up to 80% of the net capital gain of the year in which they are used.

Alternative Minimum Tax (“AMT”)

- The NOL deduction is reduced from 80% to 70% of AMT income.
- Taxpayers under special waivers that exclude certain expenses or costs paid to a related person or home office from the imposition of the 20% rate and of the 51% disallowance shall not exclude more than 60% of total expenditures subject to these provisions².
- The rates applicable to transfers/purchases of personal property between affiliates will be increased based on the purchaser’s volume of business derived from Puerto Rico, as follows:

Volume of Business	Rate ³
Less than \$10 million	0.0%
From \$10 million to less than \$500 million	2.5%
From \$500 million to less than \$1,500 million	3.0%
From \$1,500 million to less than \$2,000 million	3.5%
From \$2,000 million to less than \$2,750 million	4.5%
\$2,750 million and over	6.5%

¹ Not applicable to exempt corporations under Act 73-2008 (Economic Incentives for the Development of Puerto Rico Act), Act 74-2010 (Puerto Rico Tourism Development Act), Act 83-2010 (Green Energy Incentives Act), and Act 20-2012 (Export Services Act).

² This section is applicable to waivers obtained under Section 1022.03(d)(4). No additional waivers shall be issued under such section for taxable years starting after December 31, 2014. Waivers issued before tax years starting after December 31, 2014 will continue in effect for taxable years for which they were granted. Those covering tax years starting after December 31, 2014 shall apply at the option of the taxpayer.

³ In addition, the rate applicable to the purchase/transfer of vehicles subject to excise tax is reduced from 1.5% to 0.5%.

INCOME TAXES INDIVIDUALS

INCOME TAXES - INDIVIDUALS

The following provisions will be effective for tax years starting **after 12/31/14**.

- **Income tax rates** - the Act amends Section 1021.01 - Normal Tax - and eliminates provisions establishing prospective tax rate changes based upon compliance with certain metrics. Thus, normal income tax rates applicable for 2014 shall remain in effect for tax years 2015 onwards.
- **Gradual adjustment** – in the case of taxpayers whose net taxable income is over \$500,000, the PRIRC provides for a gradual adjustment to the tax rates lower than 33% and the personal and dependents exemptions. The Act increases from \$8,423 to \$8,895 the base amount added to the 33% of the personal and dependents exemptions' calculation.
- **Donations** – the charitable contributions/donations deduction is limited to donations to nonprofit organizations duly qualified by the Secretary of the Treasury. In order to be duly qualified, nonprofit organizations are now required to demonstrate that they render services in Puerto Rico.
- **Capital losses** – the excess of capital losses over capital gains shall be 100% deductible, up to the lesser of taxable income for the year or \$1,000. Carryforward losses shall be considered short-term capital losses and shall be deductible up to 80% of the net capital gain of the year in which they are used.
- **Self-employed taxpayers** – the Act amends the following:
 - Special tax - repeals the special tax of 2% on the gross income generated by an individual for services rendered or from a trade or business when the individual's gross income exceeds \$200,000;
 - NOLs – for taxpayers reporting a net loss in trade or business for 3 consecutive years, the amount of carryover loss for the 3rd year starting after 12/31/2014 and thereafter shall be equal to 50% of the loss incurred in such year⁴.

OTHER TAX PROVISIONS

OTHER TAX PROVISIONS

The following provisions will be effective for tax years starting **after 12/31/14**.

- **Corporation of Individuals (“CIs”), Partnerships (“P”) and Special Partnerships (“SPs”)** - a shareholder's proportionate share in the loss of a CI, P, and/or SP shall not exceed 80% of the distributable share on the aggregate net income of such entities.

⁴For purposes of this provision, each type of trade or business shall be considered separately, and the rental of real property shall not be considered as trade or business.

OTHER TAX PROVISIONS (continued)

OTHER TAX PROVISIONS

- **Disallowed deductions** – the following expenses will be fully disallowed:
 - Expenses incurred or paid for services provided by a nonresident for which the taxpayer has not paid the SUT or the VAT, as applicable; and
 - Cost or depreciation of any taxable good for which the taxpayer has not paid the SUT or the VAT, as applicable.
- **Tax credits** – tax credit moratorium is extended as follows:

Credits Granted or Acquired	Available for Taxable Years
Before June 30, 2013	Beginning after 12/31/12 and before 1/1/18
From July 1, 2016 to June 30, 2017	Beginning after 12/31/16 and before 1/1/18 (50% limit) Beginning after 12/31/17 and before 1/1/19 (50% limit) Subsequently - remaining credit
From July 1, 2017 to June 30, 2018	Beginning after 12/31/17 and before 1/1/19 (50% limit) Beginning after 12/31/18 and before 1/1/20 (50% limit) Subsequently - remaining credit

- **Excise taxes** - the excise tax rate applicable to all-terrain vehicles (“ATVs”) is increased from 10% to 11.5%.

SALES & USE TAX

SALES & USE TAX (“SUT”)

Transitory provisions amending the SUT include the following:

- **Rate** - starting on July 1st, 2015 until March 31, 2016, the SUT rate shall be increased from 7.0% to 11.5% for all taxable goods and transactions.
- **Taxable services** - from October 1st, 2015 until March 31st, 2016, certain previously exempt services shall be subject to a SUT of 4.0%. These include:
 - Business-to-business (“B2B”) services⁵;
 - Designated professional services: agronomists, architects, landscape architects, attorneys, certified public accountants, brokers, sellers and real estate companies, draftsmen (*delineantes*); real estate professional appraisers, geologists, engineers, surveyors, tax return specialists (as defined by Subtitle F).

Providers of designated professional services shall be allowed to collect/pay the SUT using the cash basis method of accounting.

⁵ Except for B2B charges among related entities subject to PR tax.

SALES & USE TAX (continued)

SALES & USE TAX

- **Exempt services** - services provided by the Government of Puerto Rico; educational services (including tuition); interests and charges from financial institutions; insurance services and commissions; health and hospitalization services (including veterinary services); services rendered by individuals whose business volume is \$50,000 or less; and B2B charges between related entities subject to PR tax.
- **Payment** - for merchants whose gross sales for the preceding taxable year did not exceed \$1 million, the SUT corresponding to the month of July 2015 may be paid as follows :
 - 55% of the SUT on or before August 20, 2015 ; and
 - 45% shall be paid in 3 equal installments on or before September 20, October 20, and November 20, 2015.
- **Credits** – for periods beginning after June 30, 2015, the credit limitation (75%) is eliminated. Merchants may claim 100% of the tax liability reflected on the SUT return.
- **Prior contracts** – the Act establishes the following provisions for contracts and bids executed prior to July 1st, 2015⁶:
 - Taxable items shall be subject to the SUT rate applicable to such items at June 30, 2015. Any person who is party to a contract covered by this section may acquire such items at the rate provided in this section for the lesser of 12 months or the term of the contract. This provision shall also apply to taxable services paid before July 1, 2015.
 - Merchants having contracts under this section shall obtain a written authorization from Treasury to sell goods or provide services exempt from the SUT.
 - Initiated construction projects⁷, or those for which taxable goods and/or services have been purchased or contracted as of May 30, 2015, may register with the Department of the Economic Development & Commerce (“DEDC”). Registered projects, as well as sales of goods or services derived from such projects, shall be subject to the tax provisions effective on or before June 30, 2015. The due date to register eligible construction projects is August 28, 2015.

⁶ Includes contracts entered into after the effective date of this section, but related to bids awarded before July 1, 2015.

⁷ Initiated construction projects include those for which the proponent has filed or received approval of location, construction or other related consultation with the Permits Management Office, an autonomous municipality or the Planning Board.

VALUE ADDED TAX

VALUE ADDED TAX ("VAT")

The Act establishes that, unless otherwise provided, the SUT shall be replaced by a new VAT system effective April 1, 2016. The VAT rate applicable to taxable goods and transactions shall be 11.5%.

- **Exempt goods and transactions** - the following will not be subject to the VAT:
 - Items used by a manufacturing plant that possesses a Certificate of Exemption for Eligible Manufacturing Plants;
 - Prescription drugs and items for the treatment of health conditions;
 - Items and equipment to treat physical or physiological deficiencies (provided the submittal of proper qualification);
 - Goods and services paid or reimbursed by Medicare, Medicaid, or the health insurance program sponsored by the Government of Puerto Rico;
 - Goods and services provided to/by the United States government, its instrumentalities, and the Government of Puerto Rico;
 - Gasoline, aviation fuel, gas oil or diesel oil, crude oil, finished oil products;
 - Unprocessed food and food ingredients;
 - Machinery, medical and surgical equipment, supplies, equipment and technology used by any hospital for the provision of health services;
 - Goods imported by or sold to *bona fide* farmers;
 - Goods imported or used by a merchant dedicated to the tourism business;
 - Printed books;
 - Vehicles, vessels and heavy equipment subject to excise taxes;
 - Maritime and air shipping services;
 - Goods and services for export;
 - Financial services (excluding bank charges);
 - Lease of property subject to the room tax imposed by the Tourism Company of Puerto Rico;
 - Goods purchased with funds received under the *PAN* or *WIC* programs;
 - Sale of real property;
 - Lease of real property which constitutes the principal residence of the tenant, including students' and senior citizens' housing;
 - Lease of commercial real property;
 - Certain goods sold by nonprofit entities exempt under Section 1101.01;
 - Occasional sale of property by churches or religious organizations;
 - Educational services;
 - Child care services;
 - Health and hospitalization services (including veterinary services);
 - Certain legal services related with family law and medical malpractice; and
 - Goods imported into a foreign trade zone.

VALUE ADDED TAX (continued)

VALUE ADDED TAX

- **Imposition** – Imported goods will be subject to the VAT at the time of introduction. Resellers and service providers will be required to pay/collect the VAT, except for Small Merchants (those with annual revenues up to \$125,000 who have a valid Small Merchant’s Registration Certificate). PR residents who receive services rendered by nonresidents are required to pay the VAT.

Reporting and payment – Merchants shall submit the following:

- Declaration of Imports- generally due with the VAT payment before taking possession of the imported goods (not applicable to bonded merchants).
 - VAT on Imports Monthly Return – due on the 10th day of every month informing the imports of the preceding month and corresponding payment, if applicable.
 - VAT Monthly Return – due on the 20th of every month, informing the VAT collected/paid in the preceding month and the corresponding payment, if applicable.
 - Annual Informative Declaration for Small Merchants – due within 60 days of the income tax return due date (including extension).
- **Fiscal vouchers (“FVs”)** - Merchants whose goods/services are subject to the VAT (except for Small Merchants) will be able to claim a credit for 100% of the VAT paid, provided they obtain a FV from the selling merchant showing the amount of VAT paid. The FV shall be requested within 30 days of receipt of the goods/services; the selling merchant shall issue the FV within 30 days from the request.
 - **Accounting method** – Generally, merchants shall report and pay the VAT based on the method used to prepare the income tax return. Accrual basis merchants shall remit the VAT at the time of issuance of invoices, receipt of payment, or 30 days after delivery of goods or services, whichever occurs first. Merchants who provide designated professional services are allowed to collect/pay the VAT using cash basis instead of accrual basis.
 - **Overpayments** - Any overpayment shall be credited in subsequent filings. Merchants with overpayments of over \$10,000 for 3 consecutive months may request a refund from the Treasury.

ONGOING DEVELOPMENTS

ONGOING DEVELOPMENTS

As mentioned above, the Act establishes the creation of a Commission for Alternatives to Transform the Consumption Tax ("CATIC", by its Spanish acronym). The CATIC's main task is to submit a report on or before July 28, 2015 establishing recommendations on the viability or not of transforming the current consumption tax system.

In addition, clarifications to above discussed dispositions and the issuance of regulations, administrative determinations, circular letters, etc. to address some of the Act's requirements are expected in the future. These will be addressed in subsequent **Tax Alerts**.

Please contact us at (787) 725-1600 or at fsosa@vgmmcpa.com if you would like to subscribe or unsubscribe from these publications.

Valdés, García, Marín & Martínez, LLP is a Puerto Rico based firm of Certified Public Accountants and Consultants organized as a partnership for the practice of public accounting since 1975. Our 40 years of experience in public accounting support our commitment to excellence and professionalism.

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