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TAX ALERT 2019-03

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2018 Tax Reform



On December 10, 2018, the Governor of Puerto Rico signed Act No. 257 ("the Act") to amend the Puerto Rico Internal Revenue Code of 2011, as amended.

This **TAX ALERT** provides a summary of some of the most significant aspects of the Act related to taxation of corporations. Unless indicated, the following changes will apply for tax years starting after December 31, 2018.

- **Normal tax**

The normal tax will be reduced from 20% to 18.5%.

- **Alternative Minimum Tax ("the AMT")**

The AMT will be the greater of \$500 or 18.5% (23% if the volume of business is \$3 million or more) of the AMT taxable income that exceeds the exempt amount, instead of the actual rate of 30%.

For the calculation of the AMT taxable income, the deductions allowed will be limited to the following expenses:

- 125% of the salaries paid and reported on withholding statements.
- Amounts paid for services including rent, telecommunications, internet access and any other type of payments reported on informative returns.
- Contributions to employees' health or accident plans.
- Payments for water and electricity services.
- Amounts paid for advertising, promotion and marketing reported on informative returns.
- Amounts paid for property, contingency and malpractice insurance reported on informative returns.
- Depreciation expense using straight-line method.
- Payments for interest and taxes, bad debts, contributions to qualified retirement plans and charitable contributions.

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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For the calculation of the AMT taxable income, the corporate taxpayer can claim as deductions all ordinary and necessary expenses, as allowed for the normal tax, if the income tax return is filed with audited financial statements, an agreed-upon procedures or a compliance attestation report prepared by a CPA with a license to practice in Puerto Rico.

- **Deductions**

- **Depreciation** – A business with a volume of business of \$3 million or less may calculate the depreciation deduction using a useful life of two (2) years for machinery and equipment, furniture and fixtures and any other type of fixed asset used in the trade or business, except real property and automobiles.
- **Use and maintenance of automobiles** – Taxpayers can elect to claim the actual expenses incurred but not in excess of a standard mileage rate that will be established through regulations. The standard mileage rate shall not be below the rate established by the U.S. Internal Revenue Service.
- **Charitable contributions** – This deduction will be allowed if the contributions are made to non-for-profit entities certified by the P.R. Secretary of the Treasury that provide services to Puerto Rico residents.
- **Meals and entertainment** – This deduction will be limited to 25% of actual expenses incurred or paid (previously 50%), up to a maximum of 25% of the gross income of the taxpayer.
- **Travel expenses** – This deduction will be limited to 50% of actual expenses incurred or paid.
- **Payments for indemnity due to sexual harassment** – This deduction will be allowed, including legal fees, if the settlement does not include a non-disclosure agreement.
- **Expense allocation from related party (including a branch and its home office)** – This deduction will continue to be subject to a 51% disallowance unless the taxpayer submits a transfer pricing study following the provisions of the Section 482 of the U.S. Internal Revenue Code. If the taxpayer submits the study the allocation amount will be fully deductible.
- **Salaries paid to college students** – Private employers may deduct 150% of the salaries paid to college students subject to certain requirements. For students participating in the internship program of the Puerto Rico Treasury Department, the deduction will be 200% of the salaries paid.

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• **Optional Tax for Service Corporations**

Corporations whose source of income is substantially derived from rendering services, the income is reported on informative returns and is subject to withholding at source or estimated tax payment, may elect to pay an optional tax on gross income as follows:

<u>If Gross Income is:</u>	<u>Tax Rate will be:</u>
Not greater than \$100,000	6%
In excess of \$100,000 but not more than \$200,000	10%
In excess of \$200,000 but not more than \$300,000	13%
In excess of \$300,000 but not more than \$400,000	15%
In excess of \$400,000 but not more than \$500,000	17%
In excess of \$500,000	20%

- **Source of income** – Payments for services rendered to any agency, dependency, or instrumentality of the Commonwealth of Puerto Rico, public corporation, as well as the Legislative and Judicial Branches and the Municipalities or any other entity created by state or federal law whose funds come from the General Fund, will be considered Puerto Rico source income, even if the services are rendered outside of Puerto Rico.
- **Group of related entities** – The Act expands the definition of “group of related entities” to include limited liability corporations, partnerships, special partnerships, and corporations of individuals.
- **Income tax returns**
 - Only one signature of an officer will be required in the return.
 - Exemption from the tax return filing requirement is granted if the tax on the total gross income of the entity has been paid through withholding at source.
 - Income tax returns of large taxpayers must be certified as prepared or revised by a CPA licensed in Puerto Rico.
 - For taxable years beginning after December 31, 2016, the automatic extension granted will be for a period of six (6) months (previously 3 months). This change also applies to partnerships, special partnerships and corporation of individuals.
- **Audited financial statements** – Taxpayers required to file the returns with audited financial statements will have to submit a schedule of uncertain tax positions with the return explaining any uncertain tax position taken under U.S. GAAP.
- **Net operating losses (“NOLs”)** – The limitation for NOL deduction will be increased from 80% to 90% of the net taxable income.

Several of the changes introduced by the Act require to the Secretary of Puerto Rico Treasury Department the issuance of regulations for the implementation of the Act’s provisions.

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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