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presenta el Foro:

Foro I: Reforma Contributiva y Código de Incentivos

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Proposed Puerto Rico Tax Reform



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Foro I: Reforma Contributiva y Código de Incentivos





Foro I: Reforma Contributiva y Código de Incentivos

- welcome
- proposed Puerto Rico tax reform
- Q&A

Proposed tax reform





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Proposal of the new tax model

Initiative	Explanation
Individuals	reduction in tax rates applicable to individuals resulting in a marginal tax rate of 31%
Corporations	reduction in tax rates applicable to corporations resulting in a marginal tax rate of 31%
SUT-B2B	reduction in 4.0% B2B, to 2.0% (1/July/18) and to 0% (1/July/19)*
Reduction in SUT on prepared foods	reduction in 11.5% tax rate, to 7.0% in the case of prepared foods (1/July/2018)

*According to the PR Department of Treasury, it should be 3% on 1/1/2019 and 0% on 1/1/2020

Impact to individuals



Individuals - Overview

- reduction in regular tax rates
- changes in alternate basic tax rules (“ABT”)
- promote withholdings at source
- optional computation for self-employed individuals
 - gross income must be solely from services rendered
 - earned income must be subject to withholding
 - income must be reported on informative declarations (Forms 480.6)
 - fixed tax rate from 5% to 20%, in lieu of any other tax



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Optional computation for self-employed individuals – tax rates

Earned Income	Proposed Rate*
Up to \$100,000	5%
Between \$100,001-\$200,000	10%
Between \$200,001-\$500,000	15%
Over \$500,000	20%

*Applicable to tax years commencing after December 31, 2018

- tax rate applies to gross income without considering expenses or deductions
- tax must be covered by withholding or estimated tax



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Individuals Regular Tax Rates

Earned Income	Current Tax Rate	Proposed Rate*
Up to \$12,500	0%-7%	0%
Between \$12,501-\$21,000	7%	0.9%
Between \$21,001-\$45,000	14%	9%
Between \$45,001-\$58,000	25%	19%
Over \$58,000	33%	31%

*Applicable to tax years commencing after December 31, 2018

Individuals

Regular Tax Rates: Gradual Adjustment

- gradual adjustment to tax rates below maximum tax rate
 - for tax years after 12/31/18, adjustment will be based on a 5% tax over the **adjusted gross income** in excess of \$200,000 not to exceed \$13,273
 - currently, adjustment has been based on a 5% tax over the **net income subject to tax** in excess of \$500,000 not to exceed \$8,895 plus 33% of the personal and dependents exemptions



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Individuals

Alternate Basic Tax

Earned Income	Current Tax Rate	Proposed Rate*
Between \$25,001-\$50,000	0%	1%
Between \$50,001-\$75,000	0%	3%
Between \$75,001-\$150,000	0%	5%
Between \$150,001-\$250,000	10%-15%	10%
Over \$250,000	15%-24%	24%

*Applicable to taxable years commencing after December 31, 2018

- new rules for determining net income subject to ABT



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Summary of ABT deductions

Deductible expenses	Requirement
Salaries (125% deduction)	Informative Return (W-2)
Rents/Professional Services/Telecommunications/Internet Access	Informative return
Self-employment tax paid to the IRS (50%)	-
Utilities	Limited - to be stated under regulations
Contributions to health /accident plans	-
Advertising, promotions and marketing	Informative return
Property, contingency and responsibility insurance	Informative return
Exempt income from registered investment company	-
Exemptions under section 1031.02 (see previous slides)	-
Interest, other taxes, contributions to qualified pension plans, agricultural income, deductions applicable to individuals	-
Other ordinary & necessary expenses	AUP

Other proposed changes

- earned income tax credit from \$300 to \$2,000 per individual (refundable)
- a credit is established (\$200) per dependent, in substitution of the deduction, to Puerto Rico residents that report adjusted gross income not exceeding \$100,000 (\$600 max., non refundable)
- personal exemption is eliminated

Individuals Tax Return

- changes in requirements to file
 - Puerto Rico residents:
 - whenever gross income reduced by exemptions is more than \$0, unless the corresponding income tax has been withheld at source
 - non Puerto Rico residents/US citizens
 - whenever gross income from Puerto Rico sources reduced by exemptions is more than \$0, unless the corresponding income tax has been withheld at source
 - individuals subject to alternate basic tax
 - whenever net income subject to alternate basic tax for the tax year is \$25,000 or more

Impact to corporations





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Tax rates

- for taxable years commencing after December 31, 2018:
 - reduction on corporate regular tax rates:
 - normal tax is reduced to 19%
 - additional tax on corporations is up to a 12% (“surtax”)
 - alternative minimum tax
 - the greater of \$500 or 19% of the alternative minimum net income
 - in the case of taxpayers with volume of business of \$3 million or more the tax rate will be 23%
 - new limitations are imposed regarding deductible expenses to determine the net income subject to alternative minimum tax
 - option to claim all the ordinary and necessary expenses if taxpayer submits audited financial statements, Agreed Upon Procedures (AUP) or Compliance Attestation Reports by a CPA with license to practice in PR and that is under a peer review program

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Surtax on corporations

Taxable Income	Current Tax Rate for taxable years after 12/31/12 and before 1/1/2019	Proposed Rate – for taxable years after 12/31/18
Not greater than \$75,000	5%	5%
Over \$75,000 but not over \$125,000	\$3,750 plus 15% of the excess over \$75,000	-
Over \$125,000 but not over \$175,000	\$11,250 plus 16% of the excess over \$125,000	-
Over \$175,000 but not over \$225,000	\$19,250 plus 17% of the excess over \$175,000	
Over \$225,000 but not over \$275,000	\$27,750 plus 18% of the excess over \$225,000	
Over \$275,000	36,750 plus 19% of the excess over \$275,000	
Between \$75,001-\$425,000		\$4,500 plus 11% of the excess of \$75,000
In excess of \$425,000		\$39,500 plus 12% of the excess of \$425,000



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Summary of AMT deductions

Deductible expenses	Requirement
Salaries (125% deduction)	W-2
Services directly related	Informative return
Contributions to health or accident plans	-
Rents, telecommunications, internet	Informative return
Utilities	Limited to determination from Secretary of Treasury
Advertising, promotion and marketing	Informative return
Property, contingency and public liability insurance	Informative return
Depreciation deduction under straight line	Limited to determination from Secretary of Treasury
Interest, other taxes, bad debts, contributions to employee trusts or deferred payment plan, charitable contributions, agricultural income	-

Optional computation for corporations that provide services

- for taxable years commencing after December 31, 2018 corporations may opt to pay an optional tax if the following requirements are met:
 - Total gross income is derived from services rendered
 - Total gross income was reported on informative returns
 - Total gross income was subject to withholding at source
- if the optional computation is elected, taxpayer will not be able to claim expenses or deductions and will not be subject to the required reports



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Optional computation for corporations that provide services

Gross Income	Tax rate*
Up to \$100,000	5%
Between \$100,001-\$200,000	10%
Between \$200,001-\$500,000	15%
Over \$500,000	20%

*Applies for taxable years commencing after December 31, 2018

Corporate tax returns

- only one signature will be required
- if the total tax on gross income was paid by withholding at source no tax return will be required to be filed.
- in the case that the tax return needs to be accompanied by audited financial statements, it needs to be certified as prepared or reviewed by a Certified Public Accountant with license to practice the profession in Puerto Rico and that belongs to a peer review program

Large Taxpayers

- Large taxpayers definition is expanded to include entities operating under the following tax exemption Acts and that also submit audited financial statements and supplemental information:
 - Economic Incentives for the Development of Puerto Rico Act (Act 73-2008)
 - Tourism Development Act of Puerto Rico of 2010 (Act 74-2010)
 - Agricultural Incentives Tax Act (Act 225-1995)
 - Act to Promote the Export of Services (Act 20-2012)
 - Regulatory Law of the International Banking Center (Act 52-1989)
 - Green Energy Incentives Act (Act 83-2010)

Large Taxpayers

- to determine the volume of business of \$50 million, the aggregate amount of all the members of the group of related entities will be used.
- once it is determined that one of the related entities meets at least one of the requirements for large taxpayers, all the other entities that compose the group will be considered large taxpayers.
- in case that for any subsequent taxable year, taxpayer does not comply with the large taxpayers requirements it may request to the Secretary, through an administrative determination and by submitting evidence, not to be classified as a large taxpayer.

Large Taxpayers

- creation of a Large Taxpayers' Office
- every taxpayer that complies with at least one of the requirements mentioned in Section 1010.01(a)(35) must register with the Large Taxpayers' Office.
- an administrative fee of \$1,000 for the initial registration will be applicable
- the Large Taxpayers' Office will monitor and support large taxpayers in tax matters including audits and closing agreements, among others.

Impact to partnerships



Sale of interest in a partnership

- any profit, benefit or income derived from the sale of an interest in a partnership that generates income from sources within Puerto Rico, will constitute income from sources within Puerto Rico, to the extent that the partnership would have generated Puerto Rico source income had it sold all the assets at fair market value (FMV), independent of the residence of the partner who sells the interest.

Sale of interest in a partnership

- in the case that the seller partner is a non-resident individual or an entity not engaged in trade or business in Puerto Rico, the buyer will be required to withhold the tax of 15% on the portion of the profit that is considered from Puerto Rico sources

Continuation of partnership

- the sale or exchange of 50% or more of the total interest in a partnership's profits and capital will not be considered a technical termination.

Deductions and exemptions/exclusions from gross income



Deductions

- **deductions applicable to individuals**
 - reduces maximum deduction for mortgage interest to \$20,000, limited to 30% of the adjusted gross income for the tax year in which the deduction is claimed (tax years after 12/31/2018)
 - expands limitation to individuals 65 years old or more

Deductions

- **deductions applicable to individuals**
 - IRA's and educational contribution accounts: the contribution must be made no later than the last day of the taxable year for which the deduction is claimed (tax years after 12/31/2018)
 - eliminates deductions for health savings accounts

Deductions

- **deductions in general**
 - depreciation
 - businesses with volume of business of \$3MM or less may compute the deduction using an useful life of 2 years for fixed assets, except for real property, automobiles, among others (tax years after 12/31/2018)
 - automobiles
 - for payments made after 12/31/2017, allows the deduction for expenses for the use and maintenance subject to a limit that will be established

Deductions

- **deductions in general**
 - charitable contributions made by corporations
 - for taxable years beginning after 12/31/2017, a deduction will be allowed for charitable contributions made to non for profit entities certified by the Secretary of Treasury that provide services to residents of Puerto Rico
 - net operating losses (carryover & deduction)
 - the 90% of gross income limitation is reestablished for tax years beginning after 12/31/2018
 - in the case of individuals, eliminates the 50% limitation on the carry over of losses reported during three consecutive taxable years applicable to tax years commencing after 12/31/2018

Deductions

- **deductions in general**
 - losses pass through entities
 - reduces the limitation to 90% of the share of net income in similar entities for tax years beginning after 12/31/2018
 - employment of young college students/recent graduates
 - establishes 150% - 200% deductions on salaries paid to college students and recently graduated individuals

Deductions

- **non deductible items**
 - eliminates the 51% adjustment – related entities
 - requires transfer pricing study in the case of related entities
 - reduces to a 25% the deductible portion of meals & entertainment expenses
 - reduces to a 50% the deductible portion of travel expenses
 - payments and related legal expenses for sexual harassment will not be deductible
 - applicable to agreements with a non disclosure clause

Exclusions from gross income

- Compensations received by an employee due to dismissal up to amount received under Act 80 of May 30, 1976
- Qualified disaster aid payments made for taxable years after December 31, 2016 provided that payments are destined for assistance and support in a disaster declared area by the Governor of Puerto Rico
- Loans to employees on a disaster declared area by the Governor of Puerto Rico
- Distributions from an employee trust or Individual Retirement Account because of a disaster declared by the Governor of Puerto Rico
- Amount received by an individual as a work credit

Exemptions from gross income

- For taxable years commencing after December 31, 2018 various exemptions from gross income (tax-free interest) are eliminated:
 - interest upon mortgages on residential property located in Puerto Rico issued after January 1, 2014 (including mortgages on newly constructed property that have been issued in conjunction with the first transmission of the mortgaged property to a new owner) and secured or guaranteed under the provisions of the National Housing Act
 - securities issued under the Agricultural Loans Act of 1991
 - mortgages secured under the provisions of the National Housing Act
 - mortgages on residential property located in Puerto Rico issued after June 30, 1983 and before August 1, 1997 secured by the National Housing Act

Exemptions from gross income (continued)

- For taxable years commencing after December 31, 2018 various exemptions from gross income (tax-free interest) are eliminated:
 - mortgages on newly constructed residential property located in Puerto Rico issued after July 31, 1997 and before January 1, 2014
 - mortgages originated to provide permanent financing for the construction or acquisition of social interest housing
 - exemption on interest bearing accounts from financial institutions authorized by the Federal Government or Government of Puerto Rico for each taxpayer that is individual is reduced from \$2,000 to \$100 and for married taxpayers from \$4,000 to \$200

Exemptions from gross income (continued)

Increased amount on the exemption applicable to pensions granted by the system or retirement funds subsidized by the Government of Puerto Rico, from annuities or pensions granted by the Government of the United States of America and by the instrumentalities or political subdivisions of both governments:

- 60 years or more – exemption is increased from \$15,000 to \$25,000
- other cases – exemption is increased from \$11,000 to \$20,000

Sales and Use Tax ("SUT")





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SUT rate changes

Elimination of the 4% B2B*	Reduction of 4.5% on the SUT rate applicable to prepared food
First phase – Decrease SUT rate to a 2%, effective July 1, 2018 (3% as of January 1, 2019)	For transactions occurring after June 30, 2018
Second phase – Elimination of the SUT on B2B, effective July 1, 2019 (0% as of January 1, 2020)	The authorization must be issued by the Secretary of the Treasury

*Provided that the payments are processed using electronics methods

Audited Financial Statements



Audited financial statements

- when the volume of business is less than \$1,000,000, the business is not required to submit audited financial statements
 - for taxable years beginning after December 31, 2018 may voluntarily submit an Agreed Upon Procedures ("AUP") or a Compliance Attestation Report
 - will not be subject to the ABT and AMT limitations

Audited financial statements

- when the volume of business is greater than \$1,000,000 but less than \$3,000,000, the business may elect to submit audited financial statements
 - for taxable years beginning after December 31, 2018 may elect to submit an Agreed Upon Procedures ("AUP") or a Compliance Attestation Report
 - will not be subject to the ABT and AMT limitations

Audited financial statements

- when the volume of business is \$3,000,000 or more, the business must submit audited financial statements

Audited financial statements

- for taxable years beginning after December 31, 2018, every related entity with a volume of business of \$1,000,000 or more, and the total volume of business of the group of related entities is \$3,000,000 or more, may submit audited financial statements showing the financial position of said entity individually without the need to submit consolidated or combined audited financial statements.

Audited financial statements

- non-for-profit corporations with unrelated business income of \$3,000,000 or more will be required to submit audited financial statements for taxable years beginning after December 31, 2018

Withholding Tax at Source and Informative Returns



Withholding of tax at source on payments for services rendered

- increase in the withholding at source rate on payments for services rendered
 - for payments made before January 1, 2019 = 7%
 - for payments made after December 31, 2018 = 10%
 - service provider may elect to be subject to a withholding tax rate of 10%, 15% or 20%
 - service provider may elect to be withheld the maximum amount applicable under Section 1021.06, effective January 1, 2019
- commissions for insurance premiums paid to agents will be subject to withholding at source

Withholding of tax at source on payments for services rendered (cont.)

Exemptions for payments made after December 31, 2018

- the withholding exemption applicable to the first \$1,500 paid during a calendar year will be eliminated
- the exemption for payments for services to corporations and partnerships will only apply to payments made during the first year of operations

Withholding of tax at source on payments for services rendered (cont.)

Waivers

- the partial waiver from withholding at source increases from 3% to 5%
 - provided that the entity has submitted an AUP or an Audited Financial Statement
- individuals that elected to be taxed under the optional computation and that the prior year's gross income does not exceed \$100,000 may obtain a partial waiver of 5%

Withholding of tax at source on payments for services rendered (cont.)

New Quarterly Reconciliation Return

- any person required to withhold tax at source must file a Quarterly Reconciliation Return on or before the last day of the following months:
 - March 31st
 - June 30th
 - September 30th
 - December 31st

Informative returns

- taxpayers that fail to file informative returns to report the payments made during the year will not be able to claim such payments as an operating expense in the income tax return
 - provided that in order to deduct the payment for purposes of determining the net income subject to ABT or AMT, each payment must be informed even if the amount to report is less than \$500
 - for interest payments it will apply for taxable years beginning after December 31, 2017

Questions and Recommendations



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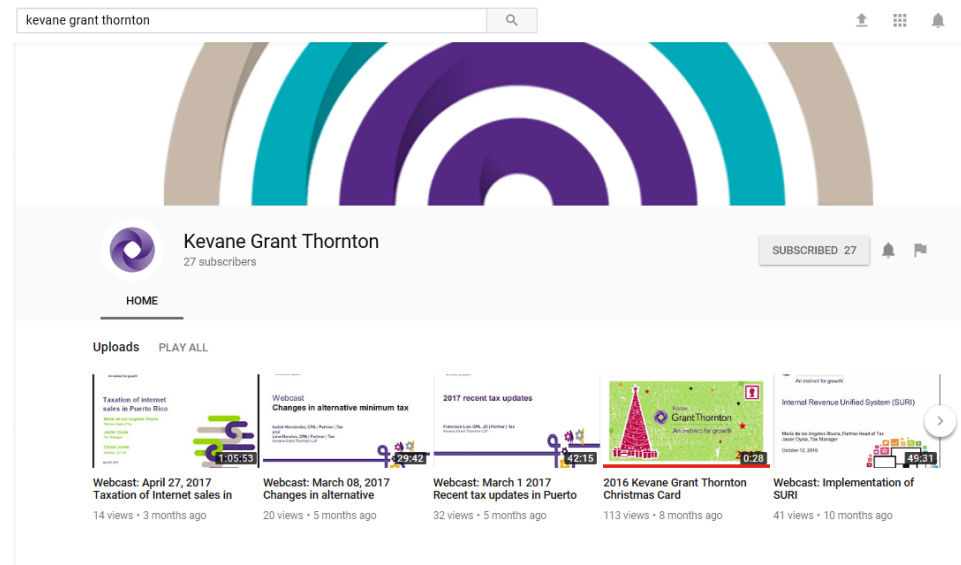
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