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TO OUR CLIENTS AND FRIENDS

Tax Changes Proposed in Connection with New Puerto Rico Budget

House Bill 1073, introduced on April 29, 2013, proposes important changes to the Puerto Rico tax laws, particularly as it relates to business operations, as follows:

Income Tax – Corporations

- **Computation of Additional Tax**

The \$750,000 deduction to determine income subject to additional tax is reduced according to the following table:

<u>If Net Income is:</u>	<u>Deduction is:</u>
Up to \$500,000.00	\$250,000.00
Between \$500,000.01 and \$1,000,000.00	150,000.00
Between \$1,000,000.01 and \$2,000,000.00	50,000.00
Over \$2,000,000.00	25,000.00

- **Alternative Minimum Tax (AMT)**

- Computation of Alternative Minimum Taxable Income

- The Book Income Adjustment is increased from 50% to **60%**.
- The Net Operating Loss deduction is reduced from 90% to **80%**.
- Effective for taxable years beginning after December 31, 2012, no adjustment is required for expenses paid to affiliates with respect to services rendered outside Puerto Rico.

- Alternative Minimum Tax Based on Purchases from Affiliates

- Increased from 1% of the value of purchases of personal property from a related person to **2%**, except that:
 - ✧ For alcoholic beverages, the rate is **.5%**,
 - ✧ For gasoline, fuels and other oil products, the rate is **1%**, and
 - ✧ For motor vehicles, the rate is **1.5%**.
- Treats the non-Puerto Rico “home office” and a Puerto Rico “branch” of a foreign corporation as “related persons” for these purposes. It appears that the intent is to treat transfers of property from the home office to the Puerto Rico branch as “purchases” for these purposes.
- Extended the AMT to taxpayers having gross receipts of \$10 million or more (previously it only applied to taxpayers with gross receipts of \$50 million or more).
- Exempts purchases from entities engaged in trade or business in Puerto Rico.
- Authorizes the Secretary to impose a lower rate.

- **Surcharge (Tax) on Intercompany Charges**

- Imposes a **20%** surcharge on expenses paid or accrued to an affiliated person that is not engaged in trade or business in Puerto Rico (including the home office of an entity operating in Puerto Rico as a branch).
- The surcharge will not apply to exempted businesses, nor to bona fide agricultural businesses, but only to the extent the deduction is attributable to the exempt operations.

Other Income Tax Changes

• Net Operating Losses

- Carryover period:
 - Is increased from 10 years to **12** years for losses incurred in taxable years beginning after December 31, 2004 and before January 1, 2013.
 - Is increased from 7 years to **10** years for losses incurred in taxable years beginning after December 31, 2012.
 - For losses incurred in taxable years beginning before January 1, 2005 continues to be 7 years.
- In the case of corporations, the Net Operating Loss deduction is limited to **90%** of net income subject to regular income tax.
- The amount of the Net Operating Loss carryover is to be reduced by **90%** of the net income for taxable years beginning after December 31, 2012, notwithstanding that the deduction is only limited to 90% for corporations.

• Partnerships, Special Partnerships and Corporations of Individuals

- In computing net income or loss, no deduction is allowed for expenses paid or accrued to a 50% or more equity holder if said expenses are not subject to Puerto Rico income or withholding tax in the taxable year in which paid or incurred.

• Individuals

- Self-employed individuals generating gross income (sales less cost of sales) in excess of \$200,000 are subject to a special tax of **2%** on their gross income from the rendering of services or conduct of a trade or business; the tax is to be paid with the individual's income tax return.
- Total deduction for mortgage interest is capped at \$35,000.

• Moratorium on Certain Tax Credits

- Certain tax credits, principally those related to solid waste treatment facilities, venture capital funds, conservation easements, revitalization of urban centers (with certain exceptions), purchase of products manufactured in Puerto Rico, and public interest housing and its infrastructure ("covered credits"), are subject a three-year moratorium. Basically, no new credits can be approved during the moratorium period, and taxpayers are precluded from using covered credits to offset any part of their income tax liability for taxable years beginning between **January 1, 2013** and **December 31, 2015**.
- A distinction is made, however, between covered credits "generated or granted" before **April 26, 2013** ("qualified covered credits") and those that do not meet such criteria.
- Purchasers or grantees of qualified covered credits will be allowed to use such credits, under the terms approved, against their income tax liability during the moratorium period, but only to the extent the qualified covered credits do not reduce said income tax liability by more than **50%**.

Effective Date

- Unless otherwise noted, all income tax changes are effective for taxable years beginning after December 31, 2012.

Sales and Use Tax

- The following previously exempted goods and services are, effective **July 1, 2013**, subject to the sales and use tax ("SUT"):
 - Services rendered to a person engaged in a trade or business or for the production of income (so-called "business to business" services). This includes **all** designated professional services (such as appraisers, architects, CPAs, engineers, lawyers and realtors), when the service is "business to business".

- Bank service charges, when the services are rendered to a business or to a person for the production of income. Presumably, this would include trustee fees charged to, among others, pension plans.
- Motor vehicle leases.
- Commercial real estate leases.
- Tax return preparation charges.
- Otherwise taxable goods and services acquired by higher learning educational institutions and cooperatives.
- Machinery, equipment, supplies, technology and medical/surgical materials used by health services facilities (hospitals) exempted under Act 168 of June 30, 1968, as amended, and not for profit hospitals exempt under Section 1101.01(a)(2).
- Goods and services acquired by child care facilities. However, amounts charged by these facilities for tuition and monthly charges would be exempt; in contrast, recreational services would be subject to the SUT, and any educational services provided would only be exempt to the extent they qualify as “educational services” for purposes of Section 4010.01(nn)(2).
- **“Back to School” Tax Holiday**
 - The “Back to School” tax holiday is now a two-day period in June and January, to be announced by the Secretary of the Treasury (“Secretary”).
 - The articles qualifying for tax-free purchase are reduced substantially, to cover basically only school uniforms and sundry school supplies, such as pens, pencils and markers.
 - However, certain textbooks are permanently exempted from SUT.
- **Resellers**
 - Resellers are subject to SUT on all purchases effected after **June 30, 2013**. A purchase will be deemed effected prior to July 1, 2013 if the item is ordered and paid for before such date, even if the delivery takes place after July 1, 2013.
 - Resellers will be allowed to claim the SUT thus paid as a credit against their liability for SUT charged to their customers, up to **50%** of such liability. Any SUT that cannot be claimed as a credit by reason of such limitation may be carried over to subsequent months, until exhausted.
 - The Secretary may change the percentage of credit above or below 50% for specific industries, as well as authorize reimbursement if the taxpayer establishes, to the satisfaction of the Secretary, the inability to recoup the SUT paid via credit.
 - Existing exemption certificates for resellers are cancelled; eligible merchants must request a new Reseller Certificate, which must be renewed on an annual basis.

Cooperatives

- Effective July 1, 2013, cooperatives would no longer be exempt from SUT or excise taxes.

Tax on Insurance Premiums

- In addition to any taxes imposed under the Insurance Code or the Puerto Rico Internal Revenue Code, insurers would be subject to a **1%** tax on all premiums subscribed after June 30, 2013.

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As is the case with any proposal of this nature, H.B. 1073 is likely to be affected by a number of changes that will take place as a result of the legislative process. We will monitor this process and will keep you informed of the status of H.B. 1073 and any changes thereto. If you have any questions or comments, or would like additional information about H.B. 1073, please call any of our tax attorneys:

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