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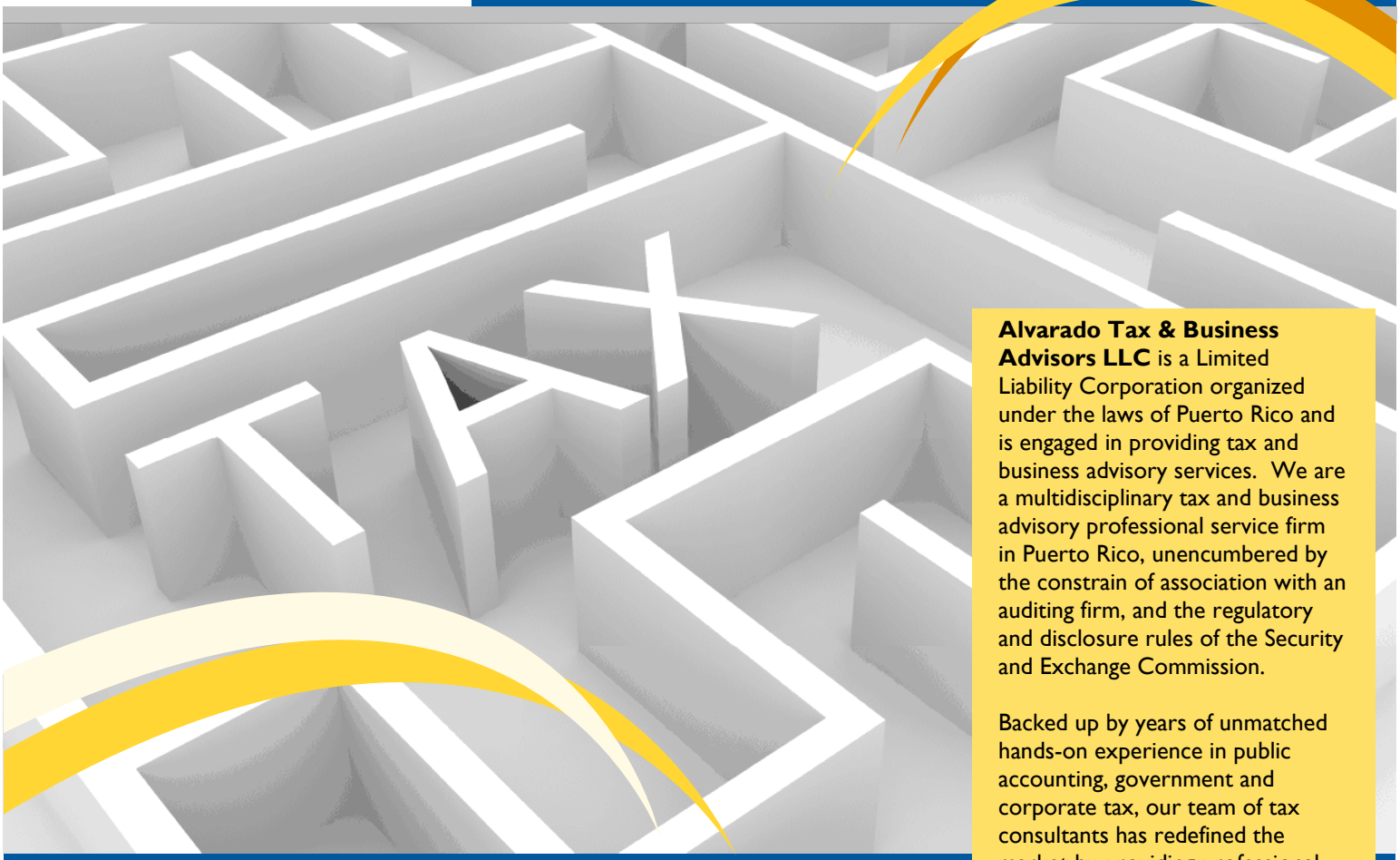

Act 72-2015: Income Tax and Excise Tax Implications

By Corali Del Llano-Torres

Although mostly known for its implications in connection with the sales and use tax ("SUT") and the value added tax ("VAT"), Act 72-2015 incorporates several other amendments to the Puerto Rico Internal Revenue Code of 2011, as amended, (the "Code") that must not go unnoticed. The purpose of this article is to summarize important amendments to income tax and excise tax provisions. For a discussion on the SUT and VAT implications please refer to our Special Bulletin "Act 72-2015: Puerto Rico's Sales and Use Tax Increases to 11.5% and Transition to a Value-Added Tax".

Income Tax – Individuals

The original version of the House Bill 2329 provided significant reductions of income taxes to individuals which, even with the high VAT tax rate, made it attractive to a significant amount of taxpayers. Those significant reductions were eliminated in the final version of the Bill when a smaller tax rate of SUT and subsequently VAT were introduced. The outcome was an actual increase in the taxation of individual with the elimination of the

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special tax on self-employed individual as a positive note to the amendments. In the following paragraphs, we will discuss the changes introduced to the Code:

Elimination of Progressive Expansion of Income Tax Brackets

The progressive expansion of the income tax brackets for taxable years commencing after December 31, 2013 are eliminated. These brackets were subject to compliance with certain tests related to expense control, general fund net income, and of economic growth. As a result, the tax bracket that was in effect for taxable years commenced after December 31, 2012 but before January 1, 2014 is now set forth for future taxable years.

Gradual Adjustment is Reinstated

The gradual adjustment had a sunset clause expiring in taxable year 2014. Act 72-2015 reestablishes the gradual adjustment indefinitely, and increases the amount of the adjustment. For taxable years commencing after December 31, 2014, the gradual adjustment shall not exceed $8,895 plus 33% of the personal and dependent exemptions.

Special Tax on Self-Employed Individuals is Eliminated

The special 2% tax on the gross income generated from services performed by a self-employed individual when the gross income of said individual exceeds $200,000 is limited to taxable years commended after December 31, 2012 and before January 1, 2015. For subsequent taxable years, the special tax is repealed.

New Limitation in the Deduction for Charitable Contributions

For taxable years commenced after December 31, 2014, contributions or gifts to nonprofit organizations that provide community service (described in section 1101.01(a)(2) of the Code) will only be deductible if the nonprofit entity is duly qualified by the Secretary of the Treasury. Nonprofit entities only qualified by the U.S. Internal Revenue Service will not qualify for the deduction.

Income Tax – Corporations

Corporations were also impacted by the changes from the original version of the House Bill 2329. Under the original version of the bill, corporations were subject to a reduced income tax rate and no major change was proposed to the alternative minimum tax provisions, retaining the impact to the intercompany transactions but not increasing them.

On the other hand, Act 72-2015 introduces various modifications to the calculation of the Alternative Minimum Tax ("AMT") applicable to corporations. New provisions are enacted in connection with the exclusion of certain expenses incurred or paid to a related person or home office, the calculation of the purchases component, and the waiver for the purchases component of the AMT calculation. In the following paragraphs we will discuss those amendments that pertain only to corporations:

Limitation on the Exclusion of Expenses Incurred or Paid to Related Party or Home Office

The waiver for the expenses or costs paid to a related person or home office is limited to 60% of total expenses subject to the AMT calculation.

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Corali is a Manager at Alvarado Tax & Business Advisors, and has over eight years of experience in the corporate and individual tax advisory areas.

Corali specializes in manufacture, construction and retail. She has experience working with complex tax issues related to tax audits, accounting for income taxes and closing agreements with the Puerto Rico Department of Treasury. She has worked with state and municipal tax exemption grant decrees, complex tax rulings to address impacting different industries and closing agreements related to municipal volume of business and construction excise taxes.

As speaker, she has participated in various seminars and workshops offered to clients such as the Autonomous Municipality of Caguas and the Puerto Rico Chamber of Commerce Students' Chapter, in areas such as the tax reform, corporate, municipal and individual tax returns, and PYMES.

Corali has a Juris Doctor degree and a Bachelor in Business Administration degree, major in Accounting, both from the University of Puerto Rico. She is a member of the Puerto Rico Certified Public Accountants Society and has been admitted to practice law in Puerto Rico and the U.S Court of Appeals, First Circuit.

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Modification of the Purchases Component

The purchases factor of the AMT calculation is modified as shown in the Table below:

	Taxable Years Commenced	
	Before January 1, 2015	**After January 1, 2015**
General Rule	2% of purchases	Tax brackets ranging from 2.5% to 6.5% depending on the gross income of the purchaser.
Exceptions		
Purchases of spirits and alcoholic beverages	0.5% of purchases	0.5% of purchases
Purchases of fuel, crude oil, unfinished oils and end products derived from oil and other hydrocarbons mixtures	0.5% of purchases	0.5% of purchases
Purchases of motor vehicles	1.5% of purchases	0.5% of purchases

Partial Waiver of the Purchases Component is Eliminated

Partial waiver for the purchases component of the AMT calculation is eliminated for taxable years commenced after December 31, 2014. However, any waiver approved will remain effective for the years granted, provided that for waivers applicable for taxable years commenced after December 31, 2014 the taxpayer may elect between the tax rate established in the waiver or the tax rates described above for taxable years after January 1, 2015. The Act forbids the Secretary of the Treasury to issue any ruling or enter into any closing agreement in connection with the purchases component for any taxable year after December 31, 2014.

Limitation of AMT Net Operating Loss Deduction is Increased

Net operating loss ("NOL") deduction for the determination of the alternative minimum net income is reduced from 80% to 70% for taxable years ended after December 31, 2014.

Income Tax – Deductions

New Limitation on Usage of Losses from Pass-Thru Entities

For taxable years commenced after December 31, 2014 losses from Pass-Thru entities are limited to 80% of the distributive share of the aggregate net income of the Pass-Thru entities.

Increase in Limitation of NOL Carry-Over

NOL carry-over allowed in the determination of net income subject to regular tax is further limited from 90% to 80% for taxable years commenced after December 31, 2014.

For individual taxpayers with NOL in their trade or business for three consecutive years, the NOL carry-over for the third

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taxable year and subsequent taxable years commenced after December 31, 2014 will be 50% of the NOL in the year, provided that this limitation will be considered for each type of industry and that real estate rental business will not be considered a trade or business.

New Limitation in the Determination of NOLs

Expenses incurred by a taxpayer and paid or to be paid to a related person or to a Home Office are not allowed as deductions (only for purposes of the determination of the NOLs). This limitation will not apply to operations covered under a tax exemptions decree issued pursuant to Act 73-2008, 74-2010, 83-2010, 20-2012 and any other similar or special act granting tax exemption to operations.

Income Tax – Non Deductible Items

Limitation on the Exclusion of Expenses Incurred or Paid to Related Party or Home Office

The waiver for the expenses or costs paid to a related person or home office is limited to 60% of total expenses for taxable years commenced after December 31, 2014.

New Non Deductible Item

Expenses incurred or paid for services rendered by a non-resident and cost or depreciation of any taxable item may not be deducted if the taxpayer has not paid the corresponding sales and use tax or value added tax, as applicable.

Income Tax – Capital Gains and Losses

Act 72-2015 further limits the usage of losses from the sale or exchange of capital assets from 90% to 80% of the gains for taxable years commenced after December 31, 2014 in the case of corporations and eliminates the 90% limitation in case of other taxpayers.

Income Tax – Moratorium of Tax Credits

Moratorium for the Concession and Usage of Certain Tax Credits is Extended

As you may recall, Act 40-2013 placed in moratorium the concession and usage of certain tax credits for a 3-year period. Act 72-2015 extends the moratorium for two additional years. Therefore, the moratorium will apply to taxable years commenced after December 31, 2012 and before January 1, 2018.

Extension of Time for the Concession of Certain Tax Credits

Concession of the following credits was extended as follows:

- Concession of tax credits up to $10,000,000 for each year under the Puerto Rico Conservation Easement Act, as amended, is extended to fiscal years 2016-2017, 2017-2018 and 2018-2019.
- Concession of tax credits under the Urban Centers Revitalization Act, as amended, is extended to fiscal years 2016-2017, 2017-2018 and 2018-2019. However, the maximum amount of credit to be granted was reduced from $40,000,000 to $20,000,000 for fiscal year 2015-2016 through 2018-2019.
- Concession of tax credits up to $5,000,000 per year under the Tax Credits for Investment in Housing Infrastructure Act, as amended, was extended to fiscal years 2016-2017 and 2017-2018.

Income Tax – New Filing Requirement

Act 72-2015 creates a new category of taxpayer denominated "Large Taxpayers", and establishes that for taxable years commenced after December 31, 2014, their tax returns shall be filed in a particular office or by electronic means as established by the Secretary of Treasury.

The term "Large Taxpayers" is defined as any taxpayer engaged in trade or business in Puerto Rico that meets ***any*** of the following criteria:

- Commercial bank or trust company;
- Private bank;
- Brokerage firm;
- Insurance company;
- Entity engaged in the telecommunications business; or
- Entity with a volume of business of $50,000,000 or more during the previous taxable year.

Income Tax – Nonprofit Entities

Act 72-2015 establishes that certain organizations must provide evidence to the effect that services are provided in Puerto Rico in order to qualify for the exemption from tax pursuant to Section 1101.01 of the Code.

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Excise Tax

New Exemption for Act 73-2008 Exempt Businesses

Fuel used by an exempted business pursuant to Act 73-2008 in the cogeneration of electric power for its own use or for the use of its affiliates and for the energy efficient equipment, properly certified by the Energy Affairs Administration will be exempt from excise tax effective July 1, 2015.

Increase in Excise Tax

Effective July 1, 2015, excise tax for "All Terrain Vehicles" or "Four Tracks" is increased from 10% to 11.5%.

ATBA Comments

The Government has introduced several modifications to our tax system in an attempt to advance collections. In an economy where "cash is king", management of cash flow has become critical and taxpayers need to understand and analyze the impact of these modifications. Just to mention a few examples, the limitation on the usage of pass-thru losses may result in additional income subject to income tax which taxpayers had not accounted for. Also, over the years the AMT calculation for corporations has gained much importance and attention, and modifications to this calculation are resulting in more entities falling into an AMT position. As a result of amendments introduced by Act 72-2015, corporations with significant transactions with related entities may be impacted by the increase in the rate of the purchases components and limitations of exclusions of certain expenses.

Furthermore, taxpayers will need to revise their estimated income tax computation taking into consideration the amendments to the Code. The use of the prior year tax as a safe harbor rule to avoid penalties for underpayment of the estimated income tax has been subject to limitations. To be in a safe positon for estimated tax penalties, taxpayers have to either pay ninety (90) percent of the current year income tax or the highest of the total tax determined as reflected on the income tax return of the prior year or an amount equal to the tax computed at the rates and under the law applicable to the taxable year using the information contained in the prior year income tax return.

Be prepared, our professionals are ready to assist you in analyzing these changes and determining their impact based on your particular circumstances.

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