



## Recent Tax Legislation and Court Cases

By: **Vicente Cajigas-Campbell**

Last month, the Governor of Puerto Rico enacted into law various bills addressing tax related matters. Below we will summarize some of them.

### Act 91-2017

In 2015, the Government of Puerto Rico introduced the Interagency Validation Portal for the Granting of Incentives for the Economic Development of Puerto Rico Act (Act 187-2015) which was promulgated with the intention to create a unified regulatory mechanism for the tax incentives in the Island. With this objective, the Act established various procedures for the concession of tax benefits, which included the issuance of a "Compliance Certificate" by certain governmental agencies. The provisions related to this Compliance Certificate were effective upon the Act's approval in November 2015. However, as of today, some instrumentalities have not been able to fully implement these provisions. As a result, considering that the Government Administration is evaluating the tax incentives available and expects to develop a new tax incentives code, the Governor

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recently approved Act 91-2017 to postpone the Compliance Certificate requirement until January 1, 2018.

### Act 92-2017

Act 92-2017 established an incentives program for the payment of certain outstanding balances with the Puerto Rico State Insurance Fund (“CFSE” for its Spanish acronym). In essence, the program covers all balances related to Workmen’s Compensation Insurance, with the exception of those related to the fiscal year 2016-2017. The main incentive of this program consists of a 50% discount on the payment of the outstanding debts from the last 15 years (except 2016-2017). Below are some highlights of the program:

- An application must be filed. The CFSE shall issue an Administrative Order establishing the details.
- All debts with the CFSE must be included in the plan.
- There are no payment plans.
- Debts older than 15 years will be eliminated.
- The program lasts 120 days counted from the issuance and effectiveness of CFSE’s Administrative Order.

### Act 94-2017

In 2012, it was introduced to our tax system Act 20-2012 better known as the “Act to Promote the Export of Services”. This Act established tax exemption benefits on export activities to its concessionaries but provided certain limitations on those benefits to entities that were engaged in export services before applying for the tax exemption grant. Among the limitations of these benefits, the Act originally stated that the reduced income tax rate shall apply only to the taxable income in excess of the base period income. The term “base period income” is basically the average taxable income generated from export activities for the three taxable years preceding the taxable year in which the application for the tax decree is filed. This base period income limitation made the Act’s income tax incentive less attractive to some entities that already had income from export activities. Accordingly, some businesses with export activities chose not to apply for the benefits under this Act. The recently approved Act 94-2017

eliminates, in a progressive manner, the base period income limitation from Act 20-2012. The base period income limitation is now reduced 25% annually, until fully exhausted in the fourth taxable year. This change is applicable to tax decrees granted after June 30, 2017.

### Update: Municipality of Caguas

As informed in one of our August 2017 editions, the Municipality of Caguas established a Municipal Business Contribution (“MBC”) of .35% over the volume of business of taxpayers located in Caguas with a volume of business of \$3,000,000 or more, applicable to the fiscal years 2017-2018 and 2018-2019. Since the very beginning, this initiative faced opposition from the business community and various taxpayers engaged in judiciary procedures, essentially claiming that the MBC is illegal and unconstitutional.

On August 23, 2017, the Court of First Instance ruled that the MBC is illegal and *ultra vires*. The Court’s decision was based on the understanding that the MBC is imposed over the same basis in which the Municipal License Tax (better known as “Patente”) is imposed. In this summary judgement that consolidated three civil cases, the Court concluded that the imposition of the MBC represents a double taxation that has the effect of increasing the maximum tax rate allowed under the Municipal License Tax Act of 1974, as amended, which is .50% in the case of non-financial businesses. As such, the Court concluded that the imposition of the MBC results in a combined Municipal License tax rate for Caguas of .85% (.50% Patente + .35% MBC), making it a tax imposed over the limit authorized by law.

It is foreseeable that the Municipality of Caguas will appeal this decision.

### **ATBA Comments:**

During the month of August, the Governor approved various legislation which provide opportunities for taxpayers to analyze and benefit from them, if applicable.

- Act 91-2017 – Provides a relief to those government agencies which still are not able to meet the requirements of Act 187-2015 and which may not issue a Compliance Certificate. However, it also provides an

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**Vicente** is a Manager at Alvarado Tax & Business Advisors. Before joining the firm he worked as Tax Senior Consultant at Deloitte Tax LLP where he provided tax compliance and consulting services to several multinational clients. His Curriculum Vitae includes experience in the corporate and individual tax advisory practice representing clients before the Puerto Rico Treasury Department on complex cases as well as also participated in the development of Closing Agreements with different governmental agencies.

With regards to specific areas of technical expertise, Vicente provides corporate and individual tax services for clients in the retail, manufacturing, and service industries, among others. At present, he manages an outsourcing division in our Firm providing finance and accounting services to local and international business entities doing business in Puerto Rico.

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opportunity to taxpayers with tax exemption decrees to evaluate their compliance with the requirements and make the necessary adjustments. Taxpayers that are not in compliance with the requirements under the tax exemption decrees should analyze which steps they may take to comply with those requirements or analyze the possibility of amending the decree.

- Act 92-2017 – We encourage employers to obtain a current debt certificate from the CFSE to verify its accuracy and determine if the incentives program may be an alternative. Our tax professionals will be monitoring the communications from the CFSE and will be ready to assist you once the incentives program is in place. The incentives program offers a great discount deal to clear debts with the CFSE. We were recently informed that the CFSE is starting with this process.
- Act 94-2017 – The elimination of the base period income limitation on tax decrees under Act 20-2012 brings an attractive opportunity to businesses with export activities that have not gotten these tax incentives.

The decision by the Court of First Instance was also an extremely important outcome in August. This decision is not only relevant to merchants in Caguas, but also to those operating in other municipalities in the Island. Caguas was one of the first municipalities to try to impose this type of tax. It was foreseeable that other municipalities would have followed if Caguas had been successful.

However, with the decision of the Court of First Instance, merchants in the Municipality of Caguas do not have to pay the remaining balance of the MBC installments, unless the Municipality prevails on its appeal. However, if the Municipality decides not to appeal or does not prevail on them, the merchants are left to decide how to recover the funds already deposited with the Municipality. It is important to analyze the options that the merchant has to claim those funds in order to obtain the benefit of those funds as fast as possible.

In our Firm, we are constantly monitoring tax legislation that may impact your business. Stay tuned for future developments in tax matters. Our Tax Advisors may assist you in analyzing how the opportunities provided by the legislation and court cases discussed in this bulletin may benefit your operations.

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