



Alvarado Tax & Business Advisors LLC is a Limited Liability Company organized under the laws of Puerto Rico and is engaged in providing tax and business advisory services. We are a multidisciplinary tax and business advisory professional service firm, unencumbered by the constraints of an association with an auditing firm, and the regulatory and disclosure rules of the Security and Exchange Commission.

Backed up by years of unmatched hands-on experience in public accounting, government and corporate tax, our team of tax consultants has redefined the market by providing professional tax and business advisory services through our “top-heavy” structure, designed specifically to provide high level tax consulting to our clients on a more personalized basis.

For information visit us at: www.alvatax.com or contact one of our Tax Professionals for an appointment:

Ph. (787) 999-4400
E. taxadvisors@alvatax.com

Alvarado Tax & Business Advisors is part of Taxand, the World’s largest independent tax consulting organization.

Impact of Tax Reform on Business Entities

By: Juan Zaragoza-Gómez

This is the fourth of a series of newsletters issued with the objective of assisting our clients in making sense of the changes in the tax laws proposed in House Bill 1544 filed on April 16, 2018 (hereinafter referred to as the “Proposed Legislation” or the “Tax Bill”). In this issue we will be discussing the most significant amendments affecting the income taxation of business entities (i.e. corporations, companies, partnerships, etc.).

Reduction of Corporate Income Tax Rates

The regular corporate income tax rate structure has two components, the normal tax and the additional tax. Effective for taxable years beginning after December 31, 2018, the normal tax rate will be decreased from 20% to 19%. With regard to the additional tax, the proposed changes are the following:

Up to 2018	
If the Net Taxable Income is:	The tax will be:
Not over \$75,000	5%
Over \$75,000 but not over \$125,000	\$3,750 plus 15% of the excess over \$9,000
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

Impact of Tax Reform on...
Continued from Page 1

2019 and Subsequent Years	
If the Net Taxable Income is:	The tax will be:
Not over \$75,000	5%
Over \$75,000 but not over \$425,000	\$4,500 plus 11% of the excess over \$75,000
Over \$425,000	\$39,500 plus 12% of the excess over \$425,000

As can be seen from the above tables, the proposed tax rate structure is significantly lower and has only three tax brackets. The combined maximum marginal tax rate of the combination of the normal rate and the additional tax is proposed to be reduced from 39% to 31%. In addition, with respect to the table for year "2019 and Subsequent Years", it is expected that the Tax Bill be amended to reflect the correct \$4,500 and \$39,500 figures since those are not the correct figures when the applicable percentages are applied.

Limits or Expansion of Certain Deductions

From the deductions standpoint the Proposed Legislation provides the following changes:

Depreciation	Option to depreciate trade or business assets using a 2 year useful life. Available for businesses with a volume of business of less than \$3 million.
Charitable Contributions	Deduction limited to contributions made to entities certified by P.R. Treasury that provide services to P.R. residents.
Meals and Entertainment	Reduces maximum amount deductible from 50% to 25%, subject to a maximum of 25% of taxpayer's gross income.
Conventions	Limits deduction to 50% of expense incurred.
51% Adjustment to Intercompany Expense Charges for Regular Income Tax Purposes	Provides for automatic waiver if the transfer pricing study is submitted with the income tax return. Repeals the maximum waiver available under prior law that limited it to 60% of the claimed expenses.

In addition to the above changes to specific deductions, the Proposed Legislation

requires the preparation and filing of informative returns for substantially all trade or business expenses incurred. In the absence of an informative return, the expense will not be deductible. Also, quarterly returns will be required regarding the withholding for payments made for certain services.

Alternative Minimum Tax

Corporate alternative minimum tax rate is reduced from 30% to 21% in the case of taxpayers with gross income of more than \$3 million. For all other corporate taxpayers, the rate is reduced to 19%. In addition to the rate reduction, the Proposed Legislation limits for purposes of the determination of the alternative minimum net income, the deductions otherwise claimed for regular income tax purposes. However, taxpayers that submit with their return audited financial statements, together with the supplementary information currently required under the Puerto Rico Internal Revenue Code of 2011, as amended (the "Code"), will not be subject to these limitations.

Flat Tax Option for Corporate Service Providers

As discussed in the previous bulletin, the Proposed Legislation incorporates a flat tax rate option for certain corporate taxpayers. This mechanism is in lieu of determining their tax on a net income basis based on the general provisions of the Code. To qualify, the corporate taxpayers' income must be: (1) solely derived from the rendering of services, (2) reported on informative returns,

and (3) subject to the applicable income tax withholding. This tax is elective and not mandatory.

The tax rate imposed is a single rate

ABOUT THE AUTHOR
Juan Zaragoza Gómez

Juan is a Member and Co-Founder of Alvarado Tax & Business Advisors LLC (formerly Zaragoza & Alvarado LLP) with over thirty years of experience in the corporate and individual tax advisory areas and as instructor in tax issues.

From November 2014 to December 2016 Juan served as Secretary of the Treasury for the Government of Puerto Rico. During such period he also served as a member in several government boards such as the Government Development Bank, Teachers Retirement System, Puerto Rico Industrial Development Company, among others.

Among other professional experiences Juan adds to his resume being Partner in Charge of Arthur Andersen's San Juan Tax Practice, President of the Puerto Rico Certified Public Accountants Society and Assistant Secretary for Internal Revenue at the Puerto Rico Treasury Department. Over the years he has also participated in several advisory municipal and state committees regarding Tax Reforms, Sales and Use Tax and Municipal Revenue Collection among other tax topics.

Juan has a Master's Degree in Business Administration from Indiana University at Bloomington and a Bachelor Degree in Business Administration from the University of Puerto Rico.

depending on the gross income level of the taxpayer. The rates are as follows:

Gross Income Level	Tax Rate
Up to \$100,000	5%
More than \$100,000 but no More than \$200,000	10%
More than \$200,000 but no More than \$500,000	15%
More than \$500,000	20%

Impact of Tax Reform on...
Continued from Page 2

Net Operating Losses

The Proposed Legislation increases the availability of net operating losses (“NOL”) to reduce taxable income to 90% instead of the current level of 80%. This will apply to NOLs available for years beginning after December 31, 2018 (as compared to those incurred after the effective date).

However, for alternative minimum tax purposes, the NOL limitation will remain at 80%.

Automatic Extension to File the Income Tax Return

The Proposed Legislation provides for an automatic six-months extension for the filing of the income tax return of all taxpayers.

ATBA Comments

The Proposed Legislation follows a Big Brother approach to tax administration. If approved, all the transactions between businesses will need to be documented through informative returns. Only expenses that are reported to the PR Treasury Department (“Treasury”) will be allowed as a deduction. This in turn will let the government to know at any moment how much businesses earn and expend.

This increase level of compliance will require businesses to modify their operations. Further resources may be needed to handle the submission of additional informative declarations. Also, additional resources may be needed to monitor the informative declarations received to make sure they are correct in the payment reported and the tax withheld on the new quarterly returns reporting.

This additional burden will especially impact the small and medium businesses which probably do not have the personnel to handle these additional requirements nor the expertise to manage these issues.

There are also unanswered questions of how taxpayers using the accrual method of accounting will be

reporting their income and expenses since the informative returns are prepared using the cash basis method of accounting. We expect those issues to be addressed by Treasury if the Proposed Legislation is signed into law.

However, not everything in the Proposed Legislation will be negative for business entities. As mentioned in this bulletin, there will be significant tax rate reductions to certain businesses, the limitation to the deduction of intercompany expenses may be completely eliminated and some of the limitations in the NOLs will be reduced. The big winners of those benefits will be the large businesses which will enjoy a reduction of 7% in their effective tax rate (32% v. 39%) and which most likely be able to deduct the intercompany expenses that currently are limited and which in some cases are substantial in amount.

The small and medium businesses may see some small benefits but nothing close to those which the large businesses will enjoy.

If you have a question regarding the Proposed Legislation and how it may impact your business, contact one of our tax advisors.

Continues on Page 4

**Key Contacts at
Alvarado Tax &
Business Advisors LLC**

**Juan A. Alvarado-Zayas, Esq.,
CPA**

Managing Member
787-620-7730
jalvarado@alvatax.com

Juan Zaragoza-Gómez, CPA

Member
787-620-7740
jzaragoza@alvatax.com

Felipe Mariani-Franco, CPA

Member
787-620-7736
fmariani@alvatax.com

**Sandra Marie Torres-Martínez,
CPA**

Member
787-620-7728
storres@alvatax.com

**Edgardo Sanabria-Valentín,
CPA**

Member
787-999-3015
esanabria@alvatax.com

**Carlos R. González-Martínez,
CPA**

Member
787-620-7739
cgonzalez@alvatax.com

César De Jesús-Umpierre, CPA

Member
787-620-7734
cdejesus@alvatax.com

**Alvarado Tax & Business
Advisors LLC**

104 Acuarela Marginal Street
Martínez Nadal Expressway
Guaynabo PR 00969

PO Box 195598
San Juan PR 00919-5598

T. 787.999.4400
F. 787.999.4646

E. taxadvisors@alvatax.com
www.alvatax.com
www.taxand.com

Tax Is Our Business®

We are Green. Are You?



Please consider the environment before printing this publication.

This publication supports Alvarado Tax & Business Advisors' marketing of professional services. It is intended for information purposes only and should not be regarded as written advice or recommendation to undertake any position, tax related or otherwise. Readers should not consider the information contained in this publication to be complete, nor act solely on the basis of the material contain herein. Moreover, due to changing laws and associated authoritative literature, that information may not continue to apply to a reader's situation. Therefore, we encourage the readers to contact us or another qualified professional advisor to thoroughly evaluate their specific facts and circumstances; to determine if any information contained in this publication remains valid and; to discuss the potential application of such information to their particular situations.

As provided in Department of Treasury Circular 230, this publication is not intended or written by Alvarado Tax & Business Advisors, to be used, and cannot be used, by a reader or any other person or entity for purposes of avoiding tax penalties that may be imposed on any taxpayer under the Internal Revenue Code.