



## The Fiscal Impact of the Proposed Tax Reform

By: Juan Zaragoza-Gómez

This is the second of a series of newsletters designed to help you understand the proposed Tax Reform (House Bill 1544, filed on April 16, 2018, hereinafter the “Proposed Legislation or the Bill”). In our first newsletter, we analyzed the viability of the proposed amendments in the context of the fiscal constraints imposed by the Financial Oversight and Management Board of Puerto Rico (“the Board”) in the Fiscal Plan approved on April 19, 2018 (“the Plan”).

In this newsletter, we will discuss the fiscal impact of the proposed changes to assist you, from a big picture standpoint, in building up your expectations regarding the net effect of the proposed tax relief provisions and the revenue raising measures. Once you have a clear understanding of the economics of the Proposed Legislation, you will be in a better position to evaluate the proposed amendments.

For purposes of our analysis, we will segregate the fiscal impact of the income tax measures from the sales and use tax (“SUT”) measures. The figures presented in the following tables were extracted from the Plan.

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**Ph. (787) 999-4400**  
**E. [taxadvisors@alvatax.com](mailto:taxadvisors@alvatax.com)**

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**TABLE 1**  
**FISCAL IMPACT OF PROPOSED INCOME TAX MEASURES ON INDIVIDUALS (in millions)**

Fiscal Year	2019	2020	2021	2022	2023	Total
Tax Reductions	\$257	\$575	\$582	\$585	\$585	
Tax Increases: Limited Deductions	-160	-347	-348	-351	-353	
Minimum Tax	-69	-156	-158	-158	-158	
Total	\$-229	\$-503	\$-506	\$-509	\$-511	
Net Benefit	\$28	\$72	\$76	\$76	\$74	\$326

Source: The Plan

Table 1 above reflects that projected tax savings resulting from the income tax measures will be substantially offset by revenue raising measures during that period. The total aggregate projected tax savings from income tax measures of \$326 million for the five fiscal years shown above represents approximately a 3% reduction of total individual income taxes expected to be collected during that period. The Puerto Rico Treasury Department proposes basically two mechanisms to increase the tax base in the case of individuals: the elimination or reduction of deductions and a more aggressive minimum tax system (the “contribución básica alterna”, in Spanish).

**TABLE 2**  
**FISCAL IMPACT OF PROPOSED INCOME TAX MEASURES ON BUSINESS ENTITIES (in millions)**

Fiscal Year	2019	2020	2021	2022	2023	Total
Tax Reductions	\$65	\$152	\$157	\$159	\$159	
Tax Increases: AMT Withholdings	-126	-286	-289	-289	-289	
Net New Taxes	\$-61	\$-134	\$-132	\$-130	\$-130	\$-587

Source: The Plan

Table 2 above reflects that the new revenue measures applicable to business entities more than offset proposed tax reductions. The proposed income tax rate reductions are offset by a more aggressive alternative minimum tax system and increased income tax withholdings.

**TABLE 3**  
**COMBINED BUSINESS ENTITIES AND INDIVIDUALS FISCAL IMPACT OF MEASURES- INCOME TAXES (in millions)**

Fiscal Year	2019	2020	2021	2022	2023	Total
Benefits/ More Taxes Individuals	\$28	\$72	\$76	\$76	\$74	
Businesses	-61	-134	-132	-130	-130	
Total	\$-33	\$-62	\$-56	\$-54	\$-56	\$-261

Source: The Plan

**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.

As can be seen from Table 3 on the left, from the perspective of income taxes, the net effect of the proposed changes to individuals and businesses is a net increase in all years.

On next page, Table 4 shows that the amendments include a phase out of the 4% SUT currently imposed on the provision of services among businesses (“B2B”), which will initially be reduced to 2% and eventually be repealed completely. However, such reduction is not automatic

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and, instead, is applicable just to business transactions where the payment is made by electronic means. With regards to the proposed SUT reduction on prepared food, which is currently 11.5% (state and municipal rates combined), the new rate of 7% will only apply just to sold by restaurants transactions made by electronic means.

This requirement has been mentioned by the Secretary on interviews, but included only on the statement of motives on the Proposed Legislation, and has yet to be included as an amendment to Section 4210.01 of the Code.

<b>TABLE 4</b>						
<b>FISCAL IMPACT OF THE PROPOSED SALES AND USE TAX MEASURES (in millions)</b>						
<b>Fiscal Year</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>Total</b>
<b>Phase Out of B2B*</b>	<b>\$19</b>	<b>\$101</b>	<b>\$169</b>	<b>\$172</b>	<b>\$172</b>	
<b>Reduction SUT on Food</b>	<b>79</b>	<b>87</b>	<b>87</b>	<b>87</b>	<b>87</b>	
<b>Total Tax Savings</b>	<b>\$98</b>	<b>\$188</b>	<b>\$256</b>	<b>\$259</b>	<b>\$259</b>	<b>\$1,060</b>
* Business to Business = SUT on Certain Services						
Source: The Plan						

**ATBA Comments**

As reflected in the previous tables, from an income tax perspective, the proposed amendments result in minimal aggregate tax savings to individuals and corporations. However, that should not be interpreted to mean that most individual taxpayers will not realize any income tax benefit, since probably most of the tax savings will fall mainly on salaried individuals (except highly compensated individuals) and the increased tax burden will fall mainly on the self-employed individuals.

In the case of corporations, the clear winners are large corporations which will see their tax responsibility reduced by as much as 20%. The losers will be the "PYMES", which will see their ability to claim deductions limited unless they hire a CPA to provide assurance to the Puerto Rico Treasury Department. From a sales and use taxes standpoint the tax reduction will certainly benefit businesses and service providers. Also, it will benefit those individuals who dine out frequently.

If you need to analyze any specific tax impact the Proposed Legislation may have on your business or individual tax return, please contact us as our tax professionals can run these estimates for you.

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**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  
 Martinez 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

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