



# Puerto Rico Income Tax Deductions for Corporations: A Step-by-Step Guide

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This publication is part of a four-part series – Pass-through Entities, Corporations, and Individuals. For a discussion on our previous articles in this series, refer to the following links:

[Three become One: The New Pass-Through Entity Category | Grant Thornton](#)  
[Puerto Rico Opens its Doors for Disregarded Entities | Grant Thornton](#)

Carlo Medina, CPA  
Tax Manager

Collaborated in the preparation of this article.

## Introduction

When it comes to managing finances, understanding and optimizing income tax deductions is crucial for a company. By taking advantage of eligible deductions, businesses can reduce their taxable income and ultimately lower their tax liability. This article aims to provide a comprehensive guide to entities engaged in trade or business in Puerto Rico with a corporation tax treatment; by offering valuable insights to help them navigate the complex landscape of tax regulations and optimize their deductions.

## Trade or Business Expenses

Generally, a trade or business expense refers to any ordinary and necessary expense incurred in the operation of a trade or business. It includes expenses that are directly related to the business activities and are considered reasonable and customary in the industry. These expenses reduce taxable income as they are typically deductible for tax purposes, based on specific rules.

Examples of operating expenses can vary depending on the nature of the business, but some may include:

Operating Expenses
<b>Employee salaries and benefits:</b> Wages, salaries, bonuses, commissions, and contributions to employee benefit plans.
<b>Rent and utilities:</b> Payments for renting business premises, utility bills, and other related expenses.
<b>Supplies and Materials:</b> Costs of purchasing office supplies or any other necessary materials for the business operations.
<b>Advertising and Marketing:</b> Expenses associated with promoting the business, such as advertising campaigns, website development, printing costs, and marketing materials.

<p><b>Professional services:</b> Fees paid to lawyers, accountants, consultants, or other professionals providing services to the company.</p>
<p><b>Travel, meals and entertainment:</b> Costs incurred for business-related travel, accommodation, meals, and entertainment, as long as they are directly related to the business and meet specific criteria set by tax regulations.</p>
<p><b>Insurance premiums:</b> Payments for insurance coverage related to the business, such as general liability insurance, property insurance, or professional liability insurance.  <b>Practice Point:</b> These payments must be made to an authorized insurer in Puerto Rico in order to be deductible in the Puerto Rico tax return. Otherwise, they are disallowed and will result in an add-back to the income.</p>
<p><b>Depreciation and amortization:</b> Deductions for the gradual wear and tear, deterioration, or obsolescence of assets used in the business, such as equipment, vehicles, or computer systems.</p>

### Deductions on the Puerto Rico Corporate Income Tax Return

Aiming to heighten its scrutiny over business deductions, the Puerto Rico Government and Treasury have imposed more rigorous requirements to allow taxpayers to claim certain expenses in their returns. Before these changes, claiming a deduction was simpler and it generally required the taxpayer to document it on their books, and be prepared to justify it as a reasonable, necessary, and ordinary business expense. Now, the availability to claim certain expenses entails more than proper documentation.

As part of this discussion, it is important to mention that in Puerto Rico, corporations may be subject to both regular tax and alternative minimum tax (AMT). Furthermore, there are some key differences between the rules and deductions for regular and AMT to consider.

Under regular tax rules, corporations in Puerto Rico can typically deduct business expenses, such as salaries, rent, utilities, advertising, and professional services; subject to certain limitations, and guidelines, and that the applicable informative tax filings are timely made.

Nevertheless, in order to claim certain deductions for AMT purposes, the corporation must include with the income tax return Audited Financial Statements (AFS) or an Agreed Upon Procedures. Both should be prepared by a CPA with a valid license from Puerto Rico. Entities that are not part of a controlled group of related entities are required to submit AFS with their tax returns if their annual volume of business totals or exceeds more than \$10 million.

In the case of entities that belong to a controlled group of related entities, the rule is different. They may be required to submit AFS with their Puerto Rico income tax return if their combined annual volume of business is \$10 million or more. The test to verify if the AFS is required is made by each individual entity. If the entity's gross volume equals or exceeds \$3 million, it must include AFS. Nonetheless, if the entity's gross volume is less than \$3 million, it must submit an AUP or has the option to submit AFS to claim the expenses for AMT purposes. The decision to prepare one or the other is based on their cost and usefulness. AFS can also be used for bank purposes, may be required by suppliers, or to address other business needs. AUPs may be less costly but their use is more limited since they are specifically prepared for the income tax return.

There are three categories of income tax deductions in the return. They are as follows: (1) Deductions that must be reported on informative returns, (2) Deductions that are not required to be reported on informative returns, and (3) Other deductions that are required to be reported in AFS or AUPs. The rationale for these classifications is to ease the tax return review process for the PR Treasury. Therefore, the reporting requirements are higher for those expenses that are more difficult to verify through a secondary source.

The first category of the aforementioned tax deductions includes certain expenses that in order to be claimed on the tax return, the taxpayer must validate them with the filing of informative returns (Forms 480). It was a challenge for PR Treasury to match the deduction and income on this type of expense and it is why they decided to implement this process. Although it could be done by the same taxpayer, since it is an automated process, it facilitates their review.

These forms are due annually by the end of February, but even if they are not filed on time, the corporation may claim the deduction and it will be subject to a late filing penalty of \$500 per each informative.

*Practice Point:* If the company fails to meet the deadline, it is suggested to analyze the impact of the deduction versus the cost of the penalty to be incurred. In most cases, the tax savings would be higher than the penalties to be incurred.

The second category consists of several other deductions as indicated in the summary provided below.

Finally, the deductions subject to AFS or AUP indicated on the third category of expenses must be supported by these reports to validate the deductions for purposes of AMT.

*Practice Point:* There are further requirements on this category of expenses, such as the payment of sales and use tax and filing of the respective monthly tax returns, that will also be taken into consideration for the application of the deduction.

Below, we include a summary of the expenses included within these three types of categories reported on the Puerto Rico Corporation Income Tax Return (Form 480.20).

TAX DEDUCTIONS	
<b>1. Deductions that must be reported on informative return:</b>	
<ul style="list-style-type: none"><li>• Compensation to directors</li><li>• Compensation to officers</li><li>• Salaries, commissions and bonuses to employees</li><li>• Salaries paid to young university students</li><li>• Payments for services rendered in Puerto Rico</li><li>• Services subcontracted</li><li>• Lease, rent and fees paid</li><li>• Insurance premiums</li><li>• Telecommunication services</li><li>• Internet and cable or satellite television services</li><li>• Bundles</li><li>• Advertising</li><li>• Royalties</li><li>• Payments for virtual and technological tools and other subscriptions</li><li>• Professional associations fees and memberships paid for the benefit of employees</li><li>• Homeowners' association fees</li><li>• Payments for judicial or extrajudicial indemnification</li><li>• Certain other expenses</li></ul>	
<b>2. Deductions not reported on informative return:</b>	
<ul style="list-style-type: none"><li>• Interests in business debt</li><li>• Other taxes</li><li>• Sales and use tax</li><li>• Special contribution for professional advisory services under Act 48-2013, as amended</li></ul>	

- Depreciation and amortization
- Electrical power
- Water and sewage
- Contribution to health or accidents coverages
- Contributions to pension or other qualified plans
- Deduction for employers who employ handicapped people and breastfeeding period

**3. Other deductions (subject to Audited Financial Statements or Agreed Upon Procedures to be allowable as a deduction for the determination of net income subject to AMT):**

- Automobile expenses
- Other motor vehicle expenses
- Repairs and maintenance
- Travel expenses
- Meal and entertainment expenses
- Materials and office supplies
- Materials used directly in the trade or business
- Stamps, vouchers, and fees
- Postage and shipping charges
- Uniforms
- Parking and toll
- Office expenses
- Bank fees
- Bad debts
- Contributions to educational contributions accounts
- Expenses incurred or paid to stockholders, persons or related entities outside of Puerto Rico
- Deduction for expenses incurred or paid to stockholders, persons, or related entities, fully deductible
- Losses from fires, storms, other casualties, or theft
- Expenses in property leased to the Puerto Rico Industrial Development Company or warehouse of the Puerto Rico Trade and Export Company
- Management fees
- Other deductions

### Tax Planning

Effective tax planning is an important task because it allows entities to identify legitimate strategies and opportunities to minimize their tax liability. By understanding the tax laws, deductions, credits, and exemptions applicable to their business, corporations can optimize their financial position by reducing the amount of taxes they owe. In addition, they can ensure timely compliance with the informative return filings that are required for the PR Treasury to validate certain expenses claimed on the tax return and avoid the imposition of penalties for failure to file them.

By minimizing tax payments, businesses can strategically manage their cash flow and free up funds to reinvest in their operations, expand their business, or address other financial needs.

As indicated before, tax laws and regulations can be complex and subject to frequent changes. Engaging in tax planning ensures that corporations stay up to date with the latest rules and requirements. By proactively planning and structuring their finances in accordance with tax laws, businesses can remain compliant, avoiding penalties, fines, and potential legal issues.

In summary, tax planning is crucial for corporations and helps positioning themselves for long-term success. We recommend taxpayers consult their tax advisors near year-end to project next year's expenses, review their filing requirements, and timely engage the

team of professionals that will be assisting them to comply with the informative returns, AFS or AUPs. As part of this analysis, it is paramount that taxpayers model their tax liabilities to analyze and determine if it is cost-effective to prepare either the AFS or AUPs. We have highly prepared professionals that are available to support your business in navigating these analyses and assist you in determining the best course of action. Our portfolio of services includes assistance with the preparation of these supporting reports. Contact us to coordinate a meeting to discuss how we can support your business with these tax matters.

We are committed to keeping you up to date with all tax-related developments. Please contact our Tax Department, should additional information be required regarding this or any other tax issue. We will gladly assist you!



**Francisco Luis**  
Partner, Head of Tax  
E [francisco.luis@pr.gt.com](mailto:francisco.luis@pr.gt.com)



**Lina Morales**  
Tax Partner  
E [lina.morales@pr.gt.com](mailto:lina.morales@pr.gt.com)



**Maria de los A. Rivera**  
Tax Partner  
E [maria.rivera@pr.gt.com](mailto:maria.rivera@pr.gt.com)



**Isabel Hernández**  
Tax Partner and IBC Director  
E [isabel.hernandez@pr.gt.com](mailto:isabel.hernandez@pr.gt.com)



**Omar Mues**  
Tax Partner  
E [omar.mues@pr.gt.com](mailto:omar.mues@pr.gt.com)

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