

# Kevane Grant Thornton Mailbag



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### Dear clients and friends:

The Kevane Grant Thornton Mailbag is your link to all our communications related to the operations of businesses in Puerto Rico. Our purpose is to offer you with up-to-date information concerning audit, tax, advisory and accounting matters that might have an impact on individuals or in the way you conduct your business in Puerto Rico.

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# Audit Alert: Timing of acquiree's ASC 606 adoption for consolidated reporting

December 18, 2017



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Questions have arisen about when a public business entity acquirer of a nonpublic acquiree should present the acquiree's results in accordance with ASC 606 in the consolidated financial statements.

Specifically, when a public business entity acquirer adopts ASC 606 on January 1, 2018 and subsequently acquires the nonpublic acquiree in, for example, June 2018, before the acquiree is required to adopt ASC 606 in its stand-alone financial statements. In light of the SEC Staff Announcement discussed below, questions have arisen about whether the acquiree may continue to apply ASC 605 after the acquisition and whether the parent acquirer may simply consolidate and report the acquiree's ASC 605 results with the parent's other results under ASC 606 until January 1, 2019—the date the acquiree otherwise would have had to adopt ASC 606.

These questions stem from consideration of the impact of an SEC Staff Announcement made at the July 2017 EITF meeting (codified in ASU 2017-13, discussed below), which states, in part, that:

The SEC Staff would not object to a public business entity that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity's filing with the SEC adopting ASC Topic 606 for annual reporting periods beginning after December 15, 2018.

This announcement narrowly focuses on an entity being considered a public business entity solely because its separate financial statements or financial information must be included in another company's SEC filing, and on whether the statements or information should reflect

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accounting standards effective for public business entities. A common example is an acquired business whose financial statements for period(s) prior to acquisition are required to be included in its acquirer's Form 8-K.

In the example fact pattern discussed above, a public business entity that has adopted ASC 606 acquires in June 2018 a nonpublic business that has not yet adopted ASC 606. In light of the announcement, if the acquired business's historic financial statements reflecting ASC 605 for periods prior to acquisition are included in an SEC filing by the acquirer, those financial statements would not have to be revised to reflect the adoption of ASC 606, even though the public business entity effective date of January 1, 2018 has passed.

The announcement, however, does not allow the acquirer to continue applying ASC 605 to the acquiree's revenue transactions in ongoing consolidated financial reporting after acquisition. That is, upon acquisition, the acquirer cannot delay the acquiree's adoption of ASC 606 in consolidated financial statements. Therefore, the acquirer in the fact pattern must apply ASC 606 to the acquiree's revenue transactions from the date of the acquisition forward for the purposes of consolidated financial statements.

Source:

*Grant Thornton, On the Horizon, October 5, 2017.*

We are committed to keep you updated of all developments that may affect the way you do business in Puerto Rico. Please contact us for further assistance in relation to this or any other matter.



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Tax



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# Tax Alert: Penalties for non-compliance with Puerto Rico Treasury Department

December 18, 2017

The continuous aim of the current administration has been the provision of the adequate conditions for the resurgence and eventual re-development of Puerto Rico's economy. To that end, the Puerto Rico Treasury Department ("PRTD") has issued a series of determinations, letters and bulletins geared towards providing taxpayers with a much-needed respite from various taxes and duties. Additionally, the PRTD released an informative booklet to remind taxpayers of the impositions in failing to comply.

## Administrative Fines

Section 6030.21(b) allows the Secretary of the Treasury (the "Secretary") to impose a \$5,000 (\$10,000 in the case of recidivism) administrative fine per infraction to any taxpayer that fails to comply with any of the dispositions of the 2011 Puerto Rico Internal Revenue Code, as amended (the "Code"), or its corresponding Regulations, as well as to any person that assists in the taxpayer's non-compliance. Moreover, failure to comply with the Code and/or its Regulations is considered a misdemeanor.

## Penalty for failure to withhold

Section 6041.01(a) states that any person responsible for the withholding at source, remittance and deposit of any tax under Subtitle A of the Code will be subject to a two-percent (2%) penalty on the unpaid amount for every thirty (30) day delay, or fraction thereof, up to a twenty-four percent (24%) maximum, in addition to any other penalty prescribed by the Code. Nonetheless, in the case of failure to deposit, the

penalty will not apply if reasonable cause for omission is shown.

In regards to *salary withholdings*, the person that fails to pay or deposit these in accordance with the rules so established in the Code, will be subject to a twenty-five percent (25%) penalty on the determined insufficiency. The penalty can increase to fifty percent (50%), and even a hundred percent (100%) in the case of a repeat offender.

Similar to salary withholdings, any person that fails to remit the SUT in accordance to Section 4042.03 of the Code, will be subject to a penalty that will not be less than twenty-five percent (25%) nor exceed fifty percent (50%) of the determined insufficiency. However, the penalty may be waived by the Secretary for reasonable cause.

## Natural Persons

Section 6030.10 states that any **person** that willfully fails to comply with the payment or withholding of any tax, the filing of any return or statement, the safeguarding or submission of any records or documents for the computation, assessment or collection of any tax or fee, will be subject to those penalties and surcharges that Chapter 3 of Subtitle F imposes.

Since the term “person” is an all-encompassing, the PRTD emphasizes that all administrative and criminal penalties under Subtitle F will be applicable to both natural and juridical persons.

Moreover, any officer of a juridical entity or an individual who willfully fails to collect or truthfully account for and pay over any tax or levy imposed by the Code, will be deemed to have incurred a felony in the third degree.

Lastly, Section 6080.02 imposes a penalty equal to the total amount of the tax that was evaded, unpaid, uncollected, not withheld, not deposited, or unreported:

- any officer of a juridical entity or an individual with the obligation to collect, withhold, account for, and pay over any tax or levy established by any subtitle of the Code;

- any person who knowingly fails to collect or truthfully account for and pay over any tax or levy, in the form and terms provided by the Code; and
- any person who knowingly attempts evade or defeat any tax imposed by any subtitle of this Code or its payment.

### Note:

As highlighted in our July 1, 2016 Tax Alert, the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), seeks to provide Puerto Rico with fiscal and economic discipline through the creation of a control board, among other things. Virtually every fiscal decision by the Government of Puerto Rico will be made or approved by the Oversight Board created by PROMESA. On this regard, the board has authority to prevent the execution or enforcement of a contract, rule, executive order or regulation to the extent that it is inconsistent with the approved fiscal plan.

Please contact our Tax Department should additional information is required regarding this or any other tax issue. We will be glad to assist you.



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# Advisory Alert: A holistic approach to M&A allows thoughtful and strategic growth

December 19, 2017

It takes an upfront analysis of your own company as well as a comprehensive look at a target to be sure your growth strategy is aligned with what you'd gain from an acquisition.



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This means taking a holistic approach to every function and asset – from HR and recruitment processes, to IT functions, to supply chain and your position in the market. This approach also includes an assessment of often-undervalued assets like a customer base, culture and a brand.

“An M&A perspective is all about strategy,” says Jim Peko, Grant Thornton’s national managing principal, Transaction Services. “Are you acquiring customers, technology, products or expanding your geographic footprint? What is it you need to grow your business?” Once you establish those value drivers, you need to be sure the growth you hope to achieve through M&A is aligned with your overall growth strategy, says Peko. That alignment is key.

Any growth strategy needs to be enterprise-wide. By the same token, any acquisition has to be viewed through the focused lens of that strategy: Does this business have the viability to deliver on your plan for growth?

Before a company embarks on an M&A deal, it should take a hard look in the mirror to do a complete evaluation of its assets and growth action plan, says Chris Smith, principal, Grant Thornton Advisory Services. Honesty definitely is the best policy. “You need to have a reality check before acquisition ideation starts,” Smith says. “Do you really know what is valuable and what is a strategic asset? You want to be acquiring things that correlate or build on what you have.” Put on paper all assets and their value, he says. C-suite executives should be in agreement.

“A company may go forward with an acquisition without fully realizing that its infrastructure is far behind,” says Smith. “Before you even try to acquire a company, be honest. Realize your infrastructure may require an overhaul, and don’t take on anything.”

### Avoid these 6 reasons deals fail

The broad purpose of any M&A deal is to grow and increase profits and enterprise value. Yet the majority of deals fail, and many have reasons in common.

**Limited due diligence.** Due diligence cannot be limited to financials and tax (although the tax function should be involved early on in the M&A process). True, companies need to take a hard look at the financials and tax, but they also need to move beyond traditional diligence and focus on areas such as the quality of all aspects of operations (including the workforce), transitional or cultural diligence and a hard assessment of transaction, business and market risks.

**Cultural integration issues.** These issues need to be evaluated and differences reconciled, whether through an integration of cultures that works for all sides or by allowing respective units to run themselves. Any approach requires clear strategies.

**Overpaying.** Paying too much can be avoided by having a detailed planning process and focusing on the drivers of value throughout the process as opposed to waiting until the deal closes. Speed to attaining the synergies enhances value and increases the likelihood of success.

**Overestimating cost savings and synergies.** When this happens, a deal may well fail.

**Lack of clarity in a deal's execution.** A slow start to operational integration after a merger frustrates all parties, including employees, customers and shareholders.

**Taking a knee-jerk reaction to a deal.** Resist pressure to go forward with a deal until you've done a thorough, enterprise-wide evaluation. At the same time, don't damage a done deal by focusing on short-term gain while putting long-term goals at risk.

### Why a holistic approach matters?

Peko concurs that a clear, complete assessment is necessary. "Companies need to take a holistic approach that focuses on driving value throughout the process with a defined strategy today more than ever because of where valuations are in the market," he says. "We have historically high valuations, lots of liquidity, a very competitive market situation. You can't do just financial diligence and confirm what EBITDA (earnings before interest, tax, depreciation and amortization) is. How do you create value and strategic advantage for yourself in a competitive process?"

You do that through an enterprise-wide method that evaluates all aspects of a deal. "Is the IT system up to date? Can you consolidate the supply chain to drive value? Is the business model significantly affected by the leasing standards changes? Are there going to be pitfalls from a cultural perspective?" Peko asks. "Know all that ahead of time so you can make adjustments."

A lot of companies don't look at everything they should as assets, says Smith – for example, their customer list. "They may have access to thousands of people that all act this way and look this way and buy this way – yet they don't view that as an asset with value."

The same can be said for culture.

Cultural misalignment is a big cause of deal failure. "Cultural integration can be a slippery killer of deals," says Smith. "CFOs may roll their eyes [when it comes to viewing culture as an asset]. But if no one did an assessment of cultures, people may be disconnected and they leave."

Cultural differences that go unaddressed frequently lead to mass defections. The same can be said for uneven compensation and benefits structures.

Says Peko: “A CFO is thinking -- about whatever is put on the table as a tactic to grow -- what is the probability it will be successful? How accurate are the projections? If we go forward with a deal, are we going to achieve the synergies in the underlying investment thesis and capture projected value?” No one wants to be the one to tell the CFO who supported a big initiative to acquire a growth target that the target needs an unforeseen new technology system for \$4 million.

“The board and the C-suite need to have an M&A strategy in place,” says Peko, “and the business must have the proper infrastructure in place. Deals fail when they don’t.

“We often don’t see acquirers take as deep a dive as they should when targeting healthy companies” Peko says. “When targets are in distress, the buyers tend to be more cautious and take a more comprehensive look at the value drivers. If we can get clients to take a deeper dive analytic on a healthy company, and what has value, particularly on things like a customer base – we can better leverage that to create enhanced cash flows, drive revenue growth and create enterprise value.”

Source:

[www.grantthornton.com/library/articles/advisory/2017/holistic-approach-to-MandA-allows-strategic-growth.aspx](http://www.grantthornton.com/library/articles/advisory/2017/holistic-approach-to-MandA-allows-strategic-growth.aspx)

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# Outsourcing Alert:

## Reporting of qualified payments under Administrative Determination No. 17-21

December 19, 2017

As informed in our Tax Alert of October 9, 2017, the Puerto Rico Treasury Department (PRTD) issued the Administrative Determination 17-21 (AD 17-21) with purpose of establishing a temporary exemption on those payments made by an employer in favor of its employees to compensate the damages and losses received by individuals as a result of the passing of Hurricane Maria.



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In accordance with this Administrative Determination and in a supplementary manner, the Department of the Treasury also issued a Q & As publication with the purpose of addressing the most frequent questions arising as a result of the publication of the AD 17-21.

### Significant notes

- those qualified payments, as defined by DA 17-21, will be considered as excluded from the term "gross income" in accordance with Section 1031.01 (b) of the Internal Revenue Code of Puerto Rico of 2011, as amended ("Code").
- the employer may deduct qualified payments to determine its net income subject to income tax provided that it is reported on the employee's Withholding Statement Form W-2PR.
- qualified payments will be deductible to determine the net income subject to tax on the employer's income, regardless of whether they exceed one thousand dollars (\$ 1,000) per employee per month. However, any excess will have to be reported as taxable income in the employee's Withholding Statement (Form W-2PR) or in the informative return of income subject to withholding (Form 480.6B), as applicable.

- any payment made by a merchant to an independent contractor that is a natural person and that meets all the requirements of a qualified payment, will be considered as such even though there is no employee-employer relationship between the independent contractor and the merchant. The merchant may deduct qualified payments to determine its net income subject to income tax provided that these payments were reported on Form 480.6D, as applicable.

Links:

Administrative Determination No. 17-21

<http://hacienda.pr.gov/publicaciones/determinacion-administrativa-num-17-21>

Q & As under Administrative Determination No. 17-21

<http://www.hacienda.gobierno.pr/publicaciones/preguntas-y-respuestas-pagos-cualificados-por-concepto-de-asistencia-por-desastre-bajo-la-determinacion-administrativa-num-17-21-version-7-dic-17>

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