

Kevane mailbag

December 29, 2016 – Issue 69

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Our Kevane mailbag is your link to all our communications related to the operations of businesses in Puerto Rico. Our purpose is to offer you up-to-date information concerning tax, accounting and any other matters that might have an impact on the way you conduct business in Puerto Rico.

The Alerts contained in our mailbags can also be accessed through our website under the Publications tab\Professional Articles section or by downloading our business and tax application for mobile, tablets and iPad for free through the App Store and Google Play. We welcome your feedback at kgt@pr.gt.com

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<h3>Audit</h3> <p>FASB discuss on comments received after the draft of final ASU on goodwill impairment. Also refer to our November 2016 issue for more information.</p> <p> Read more</p>	<h3>Tax</h3> <p>Learn what constitutes a taxable and exempt income when there is a discharge of indebtedness.</p> <p> Read more</p>	<h3>Advisory</h3> <p>Valuations aren't just for selling a business; it can also help management take decisions and more.</p> <p> Read more</p>	<h3>Outsourcing</h3> <p>The Puerto Rico Treasury Department has released new guidance in relation with the withholding of income tax at source on wages paid after December 31, 2016.</p> <p> Read more</p>
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General Information Due to Holiday festivities our offices will be closed on December 26, 2016 and January 2 and 6, 2017. Best wishes and prosperity in 2017!

Audit Alert: FASB moves closer to simplifying goodwill impairment

We continue with goodwill impairment in this issue. The FASB post tentative decisions from their November 30 [meeting](#).

The Board continued its redeliberations of the proposed ASU, *Simplifying the Accounting for Goodwill Impairment*, and discussed issues related to transition, issues impacting private companies, and the effective date for entities that are not public business entities. The Board took the following actions.

Transition

The Board reaffirmed its tentative decision to require an entity to apply only certain of the transition requirements in ASC 250, *Accounting Changes and Error Corrections*, when adopting the proposed guidance on goodwill impairment. Entities would apply only those transition requirements related to (1) disclosure of the nature of, and reasons for, the change in accounting principle, including an explanation of why the newly adopted accounting principle is preferable, and (2) inclusion of the required transition disclosures in the financial statements for both the interim and annual periods of the change.

The Board also clarified that an entity would be able to adopt the amendments in the forthcoming final ASU even if it evaluates goodwill for impairment using the qualitative assessment in the period of adoption.

Private companies

The Board tentatively decided to incorporate the guidance on impairment charges when goodwill is tax deductible into the private company accounting alternative.

In addition, private companies that switch from the existing private company accounting alternative to the guidance in the forthcoming final ASU on or before the effective date would apply the guidance prospectively, and would not be required to justify preferability for this accounting change.

Entities that are not public business entities

The Board tentatively decided that entities that are not public business entities would apply the new guidance for annual and any interim impairment tests for periods beginning after December 15, 2021, with early adoption allowed.

The Board directed the staff to draft a final ASU.

Source: Grant Thornton, *On the Horizon*, December 8, 2016

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



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December 15, 2016

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Tax Alert: Determination of taxable and exempted income attributable to the discharge of indebtedness

On November 7, 2016, the Puerto Rico Treasury Department (“PRTD”) issued Administrative Determination No. 16-14 (“AD 16-14”) to discuss what constitute taxable and exempt income when there is a discharge of indebtedness related to mortgage loans or when the debtor is insolvent. Moreover, AD 16-14 institutes a mechanism for the latter case (i.e. when there is discharge of indebtedness to an insolvent debtor), whereby both the creditor and debtor will be able determine the amount of taxable and exempt income in those particular instances.

What does the forgiveness of debts mean?

The forgiveness (or cancellation) of debts results when the creditor totally or partially releases the debtor from the fulfillment of an obligation through a written agreement.

Income from discharge of indebtedness under the PR Internal Revenue Code

Pursuant to Section 1031.01(a)(6) of the 2011 PR Internal Revenue Code, as amended (“PR Code”), income derived from the discharge of indebtedness must be included as gross income for tax purposes.

Nonetheless, if the discharge of indebtedness is attributable to any of the following circumstances, the amount so derived will not be considered taxable income:

- Debt discharged under Title 11 of the United States Code;
- Debt discharged when the taxpayer is insolvent;

- Student loans forgiveness, if the discharge is allowed under the terms of the loan after the Taxpayer has worked during a determined period of time;
- The discharged indebtedness occurs as a result of the reorganization of a mortgage loan guaranteed by the qualified residence of the taxpayer.

For its part, pursuant to Section 1063.14 of the PR Code, the creditor who condones the indebtedness may claim a deduction for the loss on said discharge by issuing an Informative Declaration to the debtor.

In order to determine the exempted amount from a discharge of indebtedness transaction due to insolvency, the debtor must submit evidence of the insolvency status to the creditor. As a requirement, the debtor must submit to the creditor an *Agreed Upon Procedures Report* prepared by a *Certified Public Accountant* authorized to practice in Puerto Rico and who belongs to a *Peer Review Program*. This report must contain the required information by AD 16-14 and must be submitted within thirty (30) days after the transaction that resulted in the indebtedness discharge. However, in the case of transactions that occurred during calendar year 2016, the debtor will have until January 31, 2017 to submit to the creditor the aforementioned report.



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December 16, 2016

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The amount of discharge that constitutes exempt income to the debtor will be disclosed on *Form 480.6D, Informative Return – Exempt Income and Exempt Income Subject to Alternate Basic Tax*, while taxable income will be evidenced on *Form 480.6A, Informative Return – Income Not Subject to Withholding*.

What is a Mortgage Loan reorganization?

The PRTD has determined that a mortgage loan has been subject to reorganization when the mortgagee relinquishes his right to collect part or the entire owed amount. Examples of reorganized mortgage loans are:

- Short sales;
- Short pay-offs;
- Discharges; and
- Payment instead of performance

Exclusion of income derived from the cancellation of indebtedness by restructuring a mortgage loan

As noted above, Section 1031.01(b)(10)(A)(iv) of the PR Code states that indebtedness discharged as a result of the reorganization of a mortgage loan guaranteed by the qualified principal residence of the taxpayer will be excluded from gross income, so long as original mortgage loan debt does not exceed \$1,000,000. Therefore, the gross income exclusion under Sec. 1031.01(b)(10)(A)(iv) will only apply to the that mortgage loans that do not exceed \$1,000,000.

AD 16-14 provides an illustrative example - if the original debt related to the principal residence was \$1,250,000, the amount of exempted income will be 80%. ($\$1,000,000 / \$1,250,000$). In this example, if the balance to be discharged was \$900,000, the exempted amount would be 80%, that is, \$720,000 ($\$900,000 \times 80\%$) and the difference of \$180,000 ($\$900,000 - \$720,000$) would be taxable amount.

Exclusion of income from discharge of indebtedness due to insolvency of the debtor

In transactions where the discharge of indebtedness is due to debtor's insolvency, Section 1031.01(b)(10)(A)(ii) of the PR Code provides that the amount excluded cannot exceed the amount by which the taxpayer is insolvent. The aforesaid Code section defines *insolvency* as the excess of liabilities over the fair market value of assets determined immediately before the discharge of debt.

For example, let assume that X's assets are \$100,000, while her liabilities amount to \$150,000. After various fruitless collection efforts, Creditor A decides to forgive X's \$40,000 outstanding loan. Since the forgiven amount (\$40,000) does not exceed the insolvency amount (\$50,000), the whole \$40,000 is excluded from gross income.

On the other hand, assuming the same facts as above, but with the amount of the outstanding loan forgiven being \$60,000. In this case the forgiven amount (\$60,000) exceeds the insolvency amount (\$50,000). Since the debt discharge positions X from insolvency to solvency, only the amount that brings the taxpayer to a break-even position (i.e. \$50K) will be excluded from gross income, while the remaining amount (i.e. \$10K) will be considered taxable income.

To recap: if the discharge of indebtedness amount is lesser than the insolvency of the debtor, the total amount will be exempted. However, if the discharge from indebtedness pushed the insolvent debtor into a solvency status, only the break-even amount (that is, when the total assets equal total liabilities) shall be exempted. Any excess shall be classified as taxable income.

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

Advisory Alert: Do you know the true value of your business?

Valuation impacts on all businesses throughout their lifecycle whether buying, selling, financing, restructuring or dealing with disputes. As a finance director, you should be looking at the numbers so that you are in a position to advise your CEO and board effectively.

We are seeing a growth in demand for independent valuations driven by regulation for example, but increasingly there is a need to demonstrate increased shareholder value. So if you think valuation is irrelevant to your business because you're not looking to sell, it may be time to think again.

Learning from private equity

The merger and acquisition market is storming ahead of late with purchase prices heading towards their peak. With finance still relatively cheap and the banks coming back into the marketplace, more money is available to fund transactions, leading to higher valuations.

Private equity (PE) investors tend to be very effective not only at assessing value but also at enhancing it, because the nature of what they do requires a focus on increasing the value of a business quickly and efficiently. Knowing what a business is really worth and what it has the potential to be worth is key to their investment approach. PE therefore tends to

target businesses that are drifting or unloved, but which have untapped value within them.

However, you don't need to be looking at a sale or considering a purchase to benefit from the kind of scrutiny PE might put your business under before making an offer. Being aware of what drives value and how your business measures up to your competitors, judged by the kind of criteria private equity would use for valuation, is a valuable exercise in its own right.

Unlocking the value within your business may not make you more attractive to private equity (in some ways it will make you less attractive), but it is likely to make you more popular with banks, external investors and shareholders.

What drives value?

Although there are some variations by sector in the exact drivers and appropriate benchmarks, the key principles which drive value are common to all cases: how much cash flow does the business generate and what is the rate of return?

Building a financial model is a core element of the valuation process. Technical analysis needs to be supported by clear reasoning and an understanding of the wider context in which you are operating. You need to know not only about your levels of growth now but



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December 29, 2016

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about your prospects for growth in the future. Similarly, your margins may be good, but are there external factors that could threaten your level of profits in the future?

Valuation methods

There are three main methods of valuation that can be used to derive the value of a business: asset, market and income. Usually the valuation process will involve employing one or more of these methods and deriving an estimate of value, or more often a range of value. Whichever method is selected will invariably require establishing how comparable businesses are valued.

You should try to define the characteristics of a good company in your sector and then choose an appropriate competitor to benchmark yourself against. This will aid in highlighting potential barriers to realising value. For example:

- Are there inefficiencies in the way you operate?
- Are you missing out on a key section of the market?
- Do you need to enter new markets or withdraw from unprofitable ones?
- Do you need to develop new products or get rid of old ones?
- Do you need to invest in new systems or equipment?
- Do you lack a strong brand?

A common example in recent years has been a failure to address the digital marketplace. Businesses that engaged early with online selling created a strong engine for growth, which enhanced their value, while those who

lagged behind saw their growth potential falter.

Benchmarking in practice

Effective analysis will reveal how the market distinguishes the valuation of listed companies, which can then be used as a benchmark for valuing private companies.

Factors such as expected growth, profitability, maturity and diversity of similar companies, and the market dynamics are used to develop key valuation benchmarks. These benchmarks are used to derive a reasoned valuation range for our client's business, which supports them in agreeing a price that met their objectives, in the case of a business sale.

The key to pushing value higher

To some extent a company, like anything else, is worth what someone is prepared to pay for it. But knowing the true value of your business will not only put you in a strong position with a potential purchaser or investor, it will illuminate the steps needed to push that value higher.

See more at:

<http://www.grantthornton.co.uk/en/insights/do-you-know-the-true-value-of-your-business/>

Call us to make an appointment with one of our experienced advisors. We will be glad to assist you.

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Outsourcing Alert: PRTD Internal Revenue Informative Bulletin No. 16-15 new withholding tables

The Puerto Rico Treasury Department has issued the Internal Revenue Informative Bulletin No. 16-15 with the new withholding tables applicable to the wages paid after December 31, 2016.

This Informative Bulletin is intended to inform the availability of the new Employer's Guide. The new Employer's Guide includes changes related to net taxable income tax rates, the special deduction applicable for certain individuals, the alternative methods for calculating income tax withheld when paid supplemental wages and the applicable tax withheld to the Christmas Bonus payment.

All employers and withholding agents must ensure that they have incorporated all the amendments contained in the New Employer's Guide.

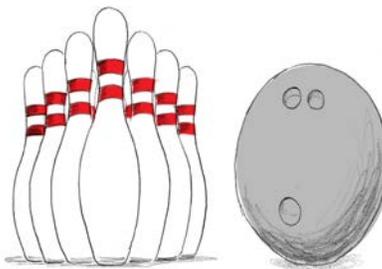
Also, the Puerto Rico Treasury Department issued the new version of the Withholding Exemption Certificate (Form 499 R-4). The new version incorporates information regarding the exemption for young entrepreneurs. Nevertheless, the employee may elect for an amount to be withheld by indicating so on the Withholding Exemption Certificate (Form 499 R-4).

Link-Employers Guide

http://www.hacienda.gobierno.pr/sites/default/files/tablas_retencion_2017_4.pdf

Link-Form 499 R-4

http://www.hacienda.gobierno.pr/sites/default/files/documentos/499_r-4_2.pdf



At Kevane Grant Thornton we provide our clients with personalized attention, valuable advice and recommendations, tailored solutions and direct access to technical experts to help clients resolve issues and identify opportunities.

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