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Kevane mailbag

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Kevane Grant Thornton LLP
33 Calle Bolivia Ste 400
San Juan, Puerto Rico 00917-2013
T + 1 787 754 1915 F + 1 787 751 1284
www.kevane.com

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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Audit

The Financial Accounting Standards Board has issued a new standard on accounting leases – ASU 2016-02.

Read more

Tax

The Puerto Rico Department of Treasury has established new filing requirements for individuals and entities effective for taxable year 2015.

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Advisory

M&A in the insurance sector continue on the rise driven by a variety of forces. Learn how our Advisory capabilities can assist you during this process.

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Outsourcing

The Internal Revenue Service has issued *Publicación 179,* with changes applicable to taxable year 2016.

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General Information

Save the Date! Tax Conference April 27, 2016. Also, be informed that our offices will remain closed on April 18.

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Audit Alert: New standard on lease accounting approved

The Board recently issued ASU 2016-02, *Leases (Topic 842)*, which requires most lessees to record a lease liability and a right-of-use asset on their balance sheets.

On February 25, the FASB released ASU 2016-02, Leases, completing its project to overhaul lease accounting. The ASU codifies ASC 842, Leases, which will replace the guidance in ASC 840.

Entities should be aware of the following key points about the new FASB standard:

- lessees will be required to recognize most leases "on balance sheet."
- the new guidance retains a dual lease accounting model for purposes of income statement recognition, continuing the distinction between what are currently known as "capital" and "operating" leases for lessees.
- lessors will focus on whether control of the underlying asset has transferred to the lessee to assess lease classification.
- a new definition of a "lease" could cause some contracts formerly accounted for under ASC 840 to fall outside the scope of ASC 842, and vice versa.
- a modified retrospective transition will be required, although there are significant elective transition reliefs available for both lessors and lessees.

The new guidance is effective for public business entities in fiscal years beginning after December 15, 2018. The effective date for most other entities is deferred for one year, meaning that most calendar-year private companies will be required to adopt the new standard in 2020. Early adoption is permitted for all entities. –

The FASB is providing the following resources to help entities learn more about the new leasing guidance:

Read *FASB in Focus*, "Accounting Standards Update No. 2016-02: *Leases (Topic 842)*"

Read "Understanding Costs and Benefits"

Register for the live webcast "IN FOCUS: FASB Accounting Standards Update on Leases"

Source: Grant Thornton, On The Horizon, March 3, 2016

Please contact our Audit Department if you need assistance with the implementation of this standard. We are committed to keep you updated of all developments that may affect the way you do business in Puerto Rico.

Contact us

For assistance in this matter, please contact us via
aida.ramirez@pr.gt.com
johanna.perez@pr.gt.com

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Tax Alert: changes affecting returns e-filing requirements and pass-thru entities

The Puerto Rico Treasury Department (the "PRTD") has issued Internal Revenue Circular Letter No. 16-06, Internal Revenue Informative Bulletin No. 16-03, and Administrative Determination No. 16-06. All of these deal with various filing aspects for the taxable year 2015.

Internal Revenue Informative Bulletin No. 16-03 ("IB 16-03")

As noted on our February 21, 2016 Tax Alert, the PRTD issued Circular Letter 16-02 ("CL 16-02") to signal the **adoption of compulsory electronic filing ("e-filing") for Individual Income Tax Returns** for taxable years beginning after December 31, 2014 (i.e. 2015) and thereafter. Nonetheless, CL 16-02 identifies certain exceptions from the e-filing requirement that should instead file their tax returns in paper so long as it is accompanied by a duly completed Form 483.20, *Exception to Electronic Filing Individual Income Tax Return.*

Informative Bulletin 16-03 reiterates that tax returns filed in paper by taxpayers that do not fall within any of the exceptions prescribed on CL 16-02, will be deemed as if they were not filed at all. Consequently, the taxpayer will be subject to all of the "failure to file" penalties that are applicable under the 2011 PR Internal Revenue Code (the "Code"), even when these were received and stamped by the PRTD. Moreover, since it is deemed an incorrect filing, the stamped filing date will not be considered valid, and therefore, the taxpayer must perform the appropriate e-filing before April 15, 2016 to avoid any interest, surcharges and penalties.

Internal Revenue Circular Letter No. 16-06-RI ("CL 16-06")

Besides CL 16-02, the PRTD has issued a number of circular letters, bulletins and determinations in its effort to facilitate the processing of tax returns and the reductions of the costs associated with their filing, through the implementation of technology. CL 16-06 deals specifically with the application of these filing measures to particular pass-through entities.

On **Tax Policy Informative Bulletin No. 16-04**, the PRTD established that for the 2015 taxable year, **pass-through entities, such as partnerships, special partnerships, corporation of individuals and limited liability companies** that have elected to be taxed as a partnership, will use Informative Declaration 480.6 EC ("Form 480.6 EC"), and that said Form must be filed electronically through the PRTD's "Hacienda Virtual" portal.

Meanwhile, **Internal Revenue Circular Letter No. 16-04-RI** determined that for taxable years commenced after December 31, 2014, Informative Declarations for **trusts** (Form 480.6 F) **and special employee-owned corporations** (480.6 CPT) must also be filed through the aforementioned "Hacienda Virtual".

Contact us

For assistance in this matter, please contact us via
maria.rivera@pr.gt.com
francisco.luis@pr.gt.com
lina.morales@pr.gt.com
isabel.hernandez@pr.gt.com

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Circular Letter 16-06 clarifies that, while the Informative Declarations **for partnerships, special partnerships, corporation of individuals and limited liability companies with pass-through elections, trusts and special employee-owned corporations** need to be filed electronically, their corresponding Tax Returns (Forms 480.2 (EC), 480.8 (F) and 480.2 (CPT)) will be filed in paper.

Both Informative Declarations and Tax Returns for the aforementioned entities, whose tax year ends December 31, are due by April 15.

Administrative Determination No. 16-06 (“AD 16-06”)

Previously, under Administrative Determination No. 12-07 (“AD 12-07”), the PRTD authorized **resident partnerships** (i.e. partnerships that are engaged in trade or business in Puerto Rico) to file Form 480.10 (SC), *Partnership Informative Tax Return – Composite*, in order to disclose the distributable share of income, gains, and losses of those partners who were intermediate pass-through entities of said resident partnership. Said Form 480.10 (SC) had to be filed no later than the fifteenth (15th) day of the third (3rd) month after the resident partnership’s tax year end.

Meanwhile, Administrative Determination No. 16-02 (“AD 16-02”) **bestowed an additional period – up to April 15, 2016** - to file Forms 480.2(EC), 480.8(F), 480.6 EC, 480.6 F and 480.6 CPT **for those Pass-Through Entities whose tax year ended on December 31, 2015.** This Administrative Determination states that *pass-through entities* include all partnerships, special partnerships, corporation of individuals, grantor trusts and special employee-owned corporations.

Taking into consideration the changes brought upon by AD 16-02, AD 16-06 extends the additional period time granted to Pass-Through Entities (i.e. April 15, 2016) for their respective filings, to resident Partnerships for the filing of Form 480.1(SC), along with any Informative Returns (480.6 EC) that need to be filed.

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

Advisory Alert: M&A in the insurance sector on the rise

The insurance and reinsurance industry is making a contribution to M&A and consolidation in its own right. Hardly a day goes by that the insurance press doesn't mention M&A — whether it is reporting on specific transactions or interviewing CEOs, COOs and CFOs about their positions on the subject. The consensus is clear: Insurance sector M&A are being driven by a variety of forces, including several new sources of capital, such as pension funds, investment banks, hedge funds and private equity. Reinsurance companies are sustaining persistent pricing pressure, and middle-tier insurance and reinsurance companies are facing regulatory capital constraints, making them attractive consolidation targets.

Objectives and drivers

The primary motivations cited for insurance acquisitions include excess capital, price competition hindering year-over-year growth, access to new distribution channels, geographic and line of business (LOB) expansion, and synergy. Regulatory capital, tax efficiency and investment strategies also merit consideration. Transactions will take the shape of "bolt-on" and/or transformational acquisitions, and are singular in form or a hybrid of one or more of the following drivers:

- **Diversification —** Broadens the acquirer's offerings, lowers capital requirements, or provides a business profile expansion where a reinsurer buys an insurer with the intent of improving returns by lessening reliance on product commoditization.
- **Distribution model —** Acquirer gains a demographic or niche advantage, which may be driven by innovation, including evolving technologies and digital transformation.
- **Scale —** Acquirer achieves growth with varying degrees of focus on LOBs, geography or distribution, or as a defensive strategy (acquire a competitor before someone else does).
- **Synergy —** Typically, fairly matched companies in terms of LOBs and geography merge to reduce expense redundancy and improve earnings.

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For assistance in this matter, please contact us via ojel.rodriguez@pr.gt.com

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In addressing excess capital, there is an added dimension regarding portfolio diversification, a fresh look at deploying capacity (e.g., risk-specific — a book or class of business), and the strengthening of balance sheets. For companies with sound capital positions, getting "bigger" is perceived as one way to manage the threat of third-party capital where, for example, private equity and hedge funds have demonstrated an appetite for investing in products, specialty carriers and specialty insurance-related businesses.

Although the industry has been profitable in recent years, pursuit of robust returns, achieving profitable premium growth, and the reality of rising expenses for technology and talent have driven the desire to acquire in deference to an organic build-out. Traditional and alternative sources of capital are shifting the shape of the industry for the rest of the decade.

Other observations

Beyond the primary drivers of M&A, several other factors play a part:

- large enterprises focusing on core businesses are likely to shed noncore businesses, providing opportunities for small- and middle-market companies to enhance scale, enter complementary lines, diversify product offerings and broaden distribution channels.
- strategic acquirers will pursue high-quality targets.
- opportunistic acquirers will behave more speculatively to avoid being squeezed out of the action or risk falling behind from being idle.
- some large, well-funded firms are content to sit on the side-lines, optimizing their current platform, while watching industry developments carefully.
- stakeholders' expectations for returns remain high.
- there is no perfect deal — alternative and hybrid structures will continue to emerge.

How we help: Strategy, due diligence, integration and transformation

Many clients and prospects may be among the industry leaders in strategic thinking, but are encumbered by limited resources and require third-party know-how for acquisition plan formulation, opportunity (target) assessment and execution. We provide insight and experience on the following strategies through the initial stages of the acquisition process:

- regulatory strategy
- tax strategy
- transaction strategy
- potential target identification

Further, in targeted acquisitions, the depth and breadth of potential latent liabilities in active, run-off and shell companies requires expert due diligence from many disciplines. The objective at this stage of the acquisition is reducing the risk of the investment decision-making process by providing data validation, comprehensive assessments of strengths (and, more importantly, gaps) and discovering facts to support the investment thesis. Exposures that potentially undermine strategic objectives must also be dealt with. We explore all facets of the acquisition target in these critical areas:

- financial
- regulatory
- tax
- technology
- operations
- human resources
- corporate culture

Acquiring companies must place significant emphasis on the success of the integration. In planning and executing around post-acquisition activities, the direction is set to pursue realization of the acquisition strategy. While many acquiring organizations are acutely aware of important decisions involving business retention, technology platform selection, cultural indoctrination, the broad array of issues and decisions around human capital, and other matters of financial consequence, working with Grant Thornton's Advisory Services can help you optimize realization.

Transformation for realization, the final important stage of acquisition and integration activity, is not always well-executed by acquirers. At this point in the acquisition process, managing to achieve the transaction's value is as critical as implementation around planned actions that improve performance of the combined organization.

Bibliography

Adapted from: Swanic, J., Tierney, M, Cox, R. (2015). M&A in the insurance sector. Retrieved March 14, 2016, from: http://www.grantthornton.com/~/media/content-page-files/financial-services/pdfs/2015/INS/150619-FIS-MA-Insurance-article-150629-FIN.ashx

We are committed to keep you updated of all developments that may affect the way you do business in Puerto Rico. Please contact one of our experienced advisors. We will be glad to assist you.

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Outsourcing Alert: What's New – Social Security and Medicare

The Internal Revenue Service has issued The Federal Tax Guide (*Publicación 179)* for Puerto Rico employers with changes applicable to taxable year 2016.

Social Security Tax 2016

The applicable social security tax rate is 6.2%, for each employee and employer, same as in 2015. The social security wage limit also did not change, remains $118,500 for taxable year 2016.

The Medicare tax rate is 1.45%, for each employee and employer, unchanged from 2015. There is no wage base limit for Medicare tax.

Social security and Medicare taxes apply to wages of household workers who you pay $2,000 or more in cash or an equivalent form of compensation. Social security and Medicare taxes apply to election workers who are paid $1,700 or more in cash or an equivalent form of compensation.

Additional Medicare Tax Withholding

In addition to withholding Medicare tax at 1.45%, employers must withhold a 0.9% Additional Medicare Tax from wages paid to an employee in excess of $200,000 in a calendar year. You are required to begin withholding Additional Medicare Tax in the pay period in which you pay wages in excess of $200,000 to an employee and continue to withhold it each pay period until the end of the calendar year.

New deadline for filing Forms W-3PR & 499R-2/W-2PR of 2016

The 499R-2/W-2PR & W-3PR forms must be filed with the Social Security Administration (SSA) **on or before January 31, 2017**. This requirement will apply to filings made on both on paper and electronically.

Link-IRS

https://www.irs.gov/pub/irs-prior/p179--2016.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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For assistance in this matter, please contact us via
julio.villegas@pr.gt.com
or
carmen.rojas@pr.gt.com

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