

# Tax Alert: House of Representatives Bill will grant broader powers to the Secretary of the Treasury

On May 9, 2016 House Bill No. 2947 (“HB 2947”) was filed in the Puerto Rico House of Representatives. The legislative piece aims to curb perceived widespread and far-reaching tax evasion practices through the enactment of technical amendments to the 2011 Puerto Rico Internal Revenue Code (“Code”). Here we provide an overview of the proposed changes.

## Alternative Minimum Tax

For Puerto Rico corporate income tax purposes, the Alternative Minimum Tax equals the amount of the **tentative minimum tax** over the amount of the **normal corporate tax** plus the applicable surtax. Pursuant to Sec. 1022.03 of the Code, the tentative minimum tax is the greater of the following amounts:

- 30% of the excess of net alternative minimum income over the exempt amount, less any allowable credit for foreign taxes paid;
- 20 % of (i) the expenses paid to a related person, (ii) transferred costs or (iii) expense allocation, if these have not been subject to PR taxation or withholding at source, PLUS the attributable tax on tangible personal property purchases between related parties or property transfers from a Home Office located outside of PR to a Branch, at the prescribed graduated tax rates.

HB 2947 will amend Sec. 1022.03 in order to limit the above referenced 20% tax on related parties’ expenses to taxable years commenced before January 1, 2016. It also eliminates the

phrase “located outside of Puerto Rico” and, correspondingly, removes the exception to the application of the tangible property purchases tax when the seller/transferor is subject to PR taxation.

## Credit for tax withholding on salaries

As a general rule, the tax deducted and withheld under Sec. 1062.01 upon salaries earned by any individual can be taken as a credit against the individual’s final fiscal responsibility for any given year. Nonetheless, some persons - such as the directors of a corporation who were in office when the withheld taxes on salaries were not duly paid to the PR Treasury Department (“PRTD”) - cannot take the credit when the amounts withheld by the corporation or partnership as income tax have not been paid to the Secretary of the Treasury (“Secretary”).

HB 2947 adds company **officers** to the list of persons who cannot credit the withheld taxes on salaries if said tax was not paid to the PRTD.

## Merchant Registration Certificate

The Merchant Registration Certificate (“Certificate”) authorizes a merchant to engage in a trade or business in Puerto Rico and establishes the merchant’s obligation to serve as a withholding agent for Sales and Use Taxes purposes. HB 2947 proposes the amendment of Sec. 4060.01 of the Code to provide that the Certificate will be valid for a period of two (2) years, and that the Secretary must institute the procedural requirements for the renewal of said Certificate.



## Contact us

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Also, the proposed legislation envisions granting the Secretary the power to deny or revoke any Merchant Registration Certificate if the merchant has tax debts or unfiled tax returns.

#### Retail dealer of alcoholic beverages

Licenses for the retail sale of alcoholic beverages are issued annually and for each location or establishment where the licensee or prospective concessionaire will serve these.

HB 2947 proposes a fourth license, *Category D*, which will be issued to businesses that serve, or allow clients to self-serve, alcoholic drinks, for consumption within their establishment, which were not sold by these businesses.

The Bill also clarifies that, with the exception of maritime vessels with a fixed itinerary who are engaged in the transportation of passengers, the alcoholic beverage license for retail dealers will only be issued to businesses that are housed within a fixed structure.

Also, HB 2947 precludes the Secretary from issuing new licenses to businesses that are situated within a 100 meters from a school, church, religious facility or rehabilitation center, unless these entities give written consent to the issuance of the license.

Lastly, the Secretary is authorized to close or interrupt a merchant's business operation if it serves alcoholic beverages without the proper license or when the merchant serves alcoholic beverages that were not subject to the corresponding excise tax. Additionally, the Secretary may levy a \$10,000 administrative fine per case on those instances where a merchant served or distributed alcoholic beverages that were acquired from exempt persons, agencies or organization.

#### Definitions

Articles 10 and 11 of the Bill seek to clarify and/or define the following terms, in the context of the assessment and collection of tax deficiencies:

- (i) a “*tax*” includes any interest, surcharge and penalty, as well as amounts withheld by a withholding agent;
- (ii) the “*last known address*” comprises the taxpayer’s last known physical, postal or email address;
- (iii) a “*withholding agent*” is any person responsible for the collection, withholding and remittance of any tax imposed by the Code;
- (iv) a “*successor taxpayer*” is defined as a taxpayer who substitutes another taxpayer in light of a transfer of assets, and who will now be responsible for the payment of the transferor’s tax liability where there is a substantial similarity in the business’ operations and identity before and after the transfer.

#### Revocation and suspension of licenses

Under the proposed legislation, a Taxpayer whose business license has been revoked or suspended by the Secretary may request a reconsideration of the latter’s determination within five (5) working days.

#### Penalty for failure to withhold or deposit income taxes

The Bill posits that any person responsible for the collection and withholding of income taxes is holding these as a special trust fund for the benefit of the Government of Puerto Rico. Moreover, the amounts so held in trust will be assessed, levied and paid in the same way, and subject to the applicable limitations (including penalties), that are attributable to the taxes from where the fund came from.

Moreover, the proposed amendment excludes these taxes held in trust from the 4-year statute of limitations for the assessment of unpaid taxes, allowing the Secretary to perform the

tax assessment at any time and impose a penalty even after the taxpayer has paid the amount due.

In particular, taxpayers that fail to pay or deposit the withheld taxes for services rendered will be subject to a penalty of no less than 25% but no greater than 50% of the unpaid amount. In the case continued non-compliance, the penalty could run up to 100% of the unpaid amount.

Though the taxpayer may get a reprieve from the imposition of the penalty if it can be demonstrated that its non-compliance was attributable to elements beyond the taxpayer's control, the insufficiency of funds will not be considered an exculpatory situation.

#### Payment of license rights

In addition to the prescribed penalties and administrative fines, the Secretary will be able to impose a penalty to any taxpayer that fails to pay the corresponding fee for the procurement or renewal of a license equal to 10% of the sales made during the period where the business operated without the required license.

#### Sales and Use Tax and Value Added Tax

As noted above for regular taxes, taxpayers responsible for the collection and withholding of sales and use taxes ("SUT") and value added taxes ("VAT") are holding these as a special trust fund for the Government of Puerto Rico, and therefore, the withheld amounts within said trust will be assessed, collected and paid in the same way, and subject to the applicable limitations with respect to the taxes from which such fund arose.

For VAT purposes, the proposed legislation explains that the insufficiency of funds will not be considered a "circumstance beyond the merchant's control" that could exonerate the merchant's failure to assess, collect and remit the corresponding VAT.

It is interesting to note that prior to HB 2947, the PR Legislature approved and submitted for the Governor's signature, a bill eliminating the proposed Value Added Tax ("VAT"). Thus, the Bill's changes to the VAT dispositions may turn out to be academic.

#### Secretary's new prerogatives and responsibilities

Among the new powers afforded to the Secretary the bill includes the ability to examine the taxpayer's books and/or documents or summon witnesses and tax preparers without the need to notify the taxpayer or begin a formal investigative inquiry.

Also, in the case of corporations, partnerships, limited liability companies or any other juridical entity that owe taxes to the PRTD, the Secretary will be also authorized to publish the name of the shareholders, partners, members or owners of said entities.

Moreover, the Secretary may close a business location lacking a current Merchant Registration Certificate or right after its revocation, and order that it remains closed for a period not to exceed 90 days or during the merchant's non-compliance period.

In terms of responsibilities, the Secretary must now publish on or before December 31 all approved and denied (i) private administrative determinations and (ii) private letter rulings issued to taxpayers during the year. These private documents will be published without identifying the taxpayers.

#### Tax liens

As general rule, if a taxpayer fails or refuses to pay his/her tax responsibility within the periods prescribed in the Code, the Secretary can proceed to collect those taxes by attachment and sale of the taxpayer's non-exempt property. The unpaid tax constitutes a lien in favor of the Government of Puerto Rico upon all personal or real property of the debtor, and as such the Secretary may require

any person holding any property, property rights, credits or money payable to the taxpayer, on any account, including salaries, accounts receivable or **bank deposits** belonging or payable to the taxpayer, not exempt from attachment, to withhold from such property or rights the amounts that the Secretary notifies him of for the purpose of covering the tax debt pending payment.

HB 2947 stipulates that the term “bank deposits” includes the taxpayer’s savings accounts, certificate of deposits and on-demand accounts on either a bank or a cooperative.

#### Liability for taxes collected

As noted, amounts held by a withholding agent in the special fund in trust for the Government of Puerto Rico, will be assessed, collected and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

Nonetheless, whereas under the current Code’s provision, this assessment can only be done within a 10-year period, HB 2947 proposes the elimination of this 10-year statute of limitations and the inclusion of penalties as part of the assessment amount.

#### Cooperatives

The Bill also aims to amend the 2002 Savings & Loan Cooperatives Act (Act 255-2002) and the Cooperatives Act (239-2004) in order to authorize the Secretary to seize the capital shares, deposits and other assets in the hands of cooperative members or partners for the payment of tax debts.

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

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