



Tax



Rates



Taxpayer

The proposed Puerto Rico tax reform

April 30, 2018

Aiming to implement the current administration's fiscal paradigm, on April 16, 2018, Gov. Ricardo Rosselló presented the House of Representatives and Senate with a bill to amend the 2011 Puerto Rico Internal Revenue Code (the "Code"). The proposed reform, H.B. 1544, seeks to simplify our existing tax structure not only by effecting fiscal measures that promote economic growth but also by fostering an environment of voluntary compliance from all sectors.

Below please find an overview of some noteworthy changes.

Definitions

The bill proposes a series of changes to the following terms:

- **Limited Liability Company:** recognition of individuals LLC's within a Series LLC as separate taxpayers.
- **Large Taxpayers:** the proposed definition now includes entities covered by a tax exemption decree. It further elucidates that in the case of a group of related entities, once it is determined that at least one of them is considered a Large Taxpayer, all of the entities that comprise that group will be considered as such.
- **Related Entities:** by substituting the word "corporation" for "entities", the proposed definition recognizes other types of organizational structures, such as partnerships, corporation of individuals, etc. as related entities.

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Individuals

Individual Tax Rates for taxable years after December 31, 2018 will be as follows:

Net taxable income	Tax rate
Up to \$12,500	0%
More than \$12,500 but not more than \$21,000	0.9%
More than \$21,000 but not more than \$45,000e	9%
More than \$45,000 but not more than \$58,000	19%
More than \$58,000	31%

Alternative Basic Tax rates are further adjusted:

Alternative Basic Net Taxable Income	Tax rate
More than \$25,000 but not more than \$50,000	1%
More than \$50,000 but not more than \$75,000	3%
More than \$75,000 but not more than \$150,000	5%
More than \$150,000 but not more than \$250,000	10%
More than \$250,000	24%

The bill revives the credit for Alternative Basic Tax paid in previous years, but makes it clear that this credit cannot be transferred, sold or refunded.

The bill proposes an Optional Tax structure for self-employed individuals who derive all of their income solely from services that are subject to withholding at source.

Gross revenue	Tax rate
No more than \$100,000	5%
More than \$100,000 but not more than \$200,000	10%
More than \$200,000 but not more than \$500,000	15%
More than \$500,000	20%

Tax is computed on gross revenues without the benefit of operating expenses or personal deductions.

In regards to deductions:

- both the personal exemption and dependent deduction are repealed. The latter is substituted for \$200 dollar tax credit per dependent (up to \$600) for resident individuals with an Adjusted Gross Income (“AGI”) of less than \$100,000.
- mortgage interest is limited to 30% of the taxpayer’s AGI, with a maximum of \$20,000.
- creation of an Earned Income Tax Credit for Puerto Rico residents with earned income that will range from \$300 to \$2,000, depending on the particular circumstances of the taxpayer.
- contributions to Individual Retirement Accounts (“IRAs”) and Education IRA’s must be made on or before December 31 in order for the individual to claim the deduction.
- elimination of the 50% limitation on the NOL Carryover for losses incurred in the individual’s trade or business.

Corporations

The normal tax rate applicable to corporations is reduced from 20% to 19%, and the surtax rates are adjusted as follows:

Surtax net income	Tax rate
No more than \$75,000	5%
More than \$75,000 but not more than \$425,000	\$4,500 + 11% of the excess over \$75,000
More than \$425,000	\$39,500 + 12% of the excess over \$425,000

Similar to the Optional Tax afforded to self-employed individuals, corporate taxpayers who derive all their income solely from services that are subject to withholding at source, may opt to pay a flat income tax on its gross income in the following manner:

Gross revenue	Tax rate
No more than \$100,000	5%
More than \$100,000 but not more than \$200,000	10%
More than \$200,000 but not more than \$500,000	15%
More than \$500,000	20%

In regards to the Alternative Minimum Tax, the current rate is reduced to 19% (23% in the case of corporations whose volume of business exceeds \$3MM). Moreover, in computing the Alternative Minimum Net Income, the bill introduces a series of changes to the deductibility of certain expenses.

What about the much-loved 51% disallowance on allocated expenses? Though the disallowance remains quite in place, the bill would allow a taxpayer to claim the allocated expenses upon the filing of Transfer Pricing Report pursuant to §482 of the U.S. Internal Revenue Code, as amended.

The bill also amends the current limitation on NOL's by increasing the deduction from 80% to 90% for taxable years commenced after December 31, 2018. Moreover, it eliminates the net income adjustments related to amounts paid or incurred to related persons in computing the NOL deduction.

The aforesaid increase from 80% to 90% deduction also applies to the distributable share in operating losses of pass-through entities.

Sales and Use Tax

The bill also proposes a series of changes to Sales and Use taxes; namely:

- reduction of the 4% B2B and designated professional services tax rate to 2% for the Fiscal Year 2018-19, with its eventual elimination after June 30, 2019, subject to electronic payment of services.
- reduction of the SUT on prepared foods from the current 10.5% to 5.5% on restaurants which receive the PR Treasury Department's approval.
- exempt commercial property lease from SUT, subject to certain Fiscal Terminal requirements.

Other taxes

- additional changes are proposed in the areas of withholdings at source, informative returns and others.

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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