



# Puerto Rico Tax Reform signed into law

**December 21, 2018**

On December 10, 2018 the Governor of Puerto Rico signed into law the Puerto Rico Tax Reform. We provide you with an overview of several of its most important aspects.

## Individuals

### Regular tax

As shown below, the tax rates for the taxable year 2017 remain in place for the taxable year 2018. Nonetheless, for the taxable years commenced after December 31, 2018, the Tax Reform will apply a 5% reduction to these rates.

Earned Income	Tax rate
Up to \$9,000	0%
More than \$9,000 but not more than \$25,000	7%
More than \$25,000 but not more than \$41,500	14%
More than \$41,500 but not more than \$61,500	25%
Over \$61,500	33%

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### Alternate basic tax (ABT)

For taxable years commenced after December 31, 2018, the tax rates will be the following:

Earned income	Tax rate
Over \$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%
Over \$250,000	24%

The Reform allows a series of new deductions when computing the Alternate Basic Tax. Moreover, the Secretary of the Treasury will allow an individual to claim the totality of his/her ordinary and necessary expenses related to trade or business if its income tax return is filed with either an Agreed-Upon Procedures Report or Compliance Attestation report prepared by a Puerto Rico CPA.

Lastly, the ABT Credit is reestablished.

### Optional Tax

The Reform introduces an Optional Tax structure for self-employed individuals who derive all of their income substantially from services that are subject to withholding at source. This optional tax will be computed on gross revenues without the benefit of operating expenses or personal deductions.

Earned income	Tax rate
Up to \$100,000	0%
More than \$100,000 but not more than \$200,000	7%
More than \$200,000 but not more than \$300,000	14%
More than \$300,000 but not more than \$400,000	25%
More than \$400,000 but not more than \$500,000	33%
More than \$500,000	25%

This optional tax will be available for taxable years commenced after December 31, 2018, although the Secretary of the Treasury may postpone its validity for taxable years commenced after December 31, 2019

## Corporations

### Regular tax

For taxable years commenced after December 31, 2018, the regular tax rate is reduced from 20% to 18.5%. Moreover, in the the case of taxpayers whose business volume is \$3MM or more, the tax rate will be 23%.

### Alternative minimum tax

The AMT will be the greater of \$500 or 18.5% of the alternative minimum net income. Although the Reform imposes new limitations on deductible expenses to determine the net income subject to alternative minimum tax, it also provides for a taxpayer to claim all ordinary and necessary expenses if it submits audited financial statements, agreed upon procedures (AUP) or Compliance Attestation Reports by a CPA licensed to practice in PR.

Deductible expenses	Requirement
Salaries (125% deduction)	W-2
Payments for services directly related to the trade or business	Informative Return
Contributions to health/accident plans for employees	-
Rents, Telecommunications, Internet	Informative Return
Utilities	<i>No limitation</i>
Advertising, Promotion and Marketing	Informative Return
Property, Contingency and Public Liability insurance	Informative Return
Depreciation under Straight-Line method	No limitation
Interest, Other Taxes, bad debts, contributions to employee trusts or deferred payment plan, charitable contributions, agricultural income	-

## Optional tax

Same as with Individuals, the Tax Reform allows an Optional Tax computation for Corporations, if the following three (3) requirements are met:

1. total gross income is substantially derived from services rendered,
2. total gross income was reported on informative returns, and
3. total gross income was subject to withholding at source or estimated tax payment

If the optional computation is elected, taxpayer will not be able to claim expenses or deductions and will not be subject to the required reports.

The applicable rates will be as follows:

Earned income	Tax Rate
Up to \$100,000	6%
More than \$100,000 but not more than \$200,000	10%
More than \$200,000 but not more than \$300,000	13%
More than \$300,000 but not more than \$400,000	15%
More than \$400,000 but not more than \$500,000	17%
More than \$500,000	20%

## Deductions

- **depreciation**
  - business with volume of \$3MM or less, may compute the deduction using a useful life of two (2) years for fixed assets used in the trade or business
    - exception: real property and automobiles
- **automobiles**
  - for payments made after December 31, 2017, allows the deduction for actual expenses incurred for use and maintenance subject to a limit that will be established through Regulations
  - deduction for mileage established by the Secretary will never be less than the one established by the IRS
- **charitable contributions**
  - for taxable years beginning after December 31, 2018, a deduction will be allowed for charitable contributions made to non for profit entities certified by the Secretary of Treasury or by the IRS that provide services to residents of PR

- **Net Operating Losses (NOL)**
  - the 90% limitation is reestablished for tax years beginning after December 31, 2018
  - the NOL will include expenses for payments made to related entities not engaged in business in PR and not subject to withholding
- **pass-through entities losses**
  - reestablishes the limitation to 90% of the share of net income in similar entities for tax years beginning after December 31, 2018
- **employment of young college students/recent graduates.**
  - establishes a 150% deduction on salaries paid to college students and recently graduated individuals who are employed for at least 20 hours a week for a period of 9 months or 800 hours a year, at a rate over \$10/hour
  - 200% deduction in the case of students who come from the internship program at the Department of Treasury
- **non-deductible items**
  - for tax years beginning after December 31, 2018, the 51% disallowance on charges between related entities is eliminated if the taxpayer files a transfer pricing study along with its income tax return.
    - the transfer pricing study must be prepared in accordance with §482 of the U.S. Internal Revenue Code, as amended.

#### Tax returns

- only one signature will be required from the President, Vice-President, Treasurer, Assistant Treasurer or other principal officer
- if the total tax on gross income was paid through withholding at source, the corporation will not be required to file a tax return
- for taxable years beginning after December 31, 2016, the automatic extension granted will be for a period of six (6) months, instead of three (3) months

#### Tax payments

- the Secretary may prescribe that tax payments be made solely through electronic means.

#### Estimated tax

- the amount due will be the lesser of 90% of such year's tax, or:
  - tax determined on the prior year tax return, or
  - tax calculated at the tax rates and under the rules applicable to such year using the data included in the prior year tax return.

#### Sales and Use Tax (SUT)

- effective October 1, 2019, the SUT on prepared food sold by restaurants will be reduced to 7%
  - *restaurants* = all commercial establishments, including food trucks, that sell food and drinks, as long as it is served hot and/or with eating utensils
  - alcoholic drinks are not included
- some definitions are modified to include additional services that need to be paid SUT over the price charge

- *Admission Rights* – include fees and charges paid to private or membership clubs that provide facilities for the purchase of goods or services
  - *Legal Services* – those provided by members of the legal profession authorized by the Puerto Rico Supreme Court to practice, or by a corresponding entity in a foreign jurisdiction, only with respect to fees for services related to legal representation before the Courts or administrative agencies, consulting and notarial services
  - *Sales Price* – in the event that a product is sold with discounts or rebates from the manufacturer or wholesaler, who then reimburses the difference, the manufacturer or wholesaler will be obliged to reimburse, along with the discount, an amount equal to the sales tax that would result if said refund were a sale
- some SUT exemptions were modified
    - lease of real property – evidence of compliance with requirements to maintain a fiscal terminal, if necessary, is required
    - lease and purchase of machinery, material, equipment, etc., used in providing health services
    - electronic books – applies to both purchase and rent
    - B2B and designated professions services provided by person whose annual business volume does not exceed \$200,000
    - effective March 1, 2019
    - personal hygiene products for women

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



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