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Tax
Taxpayers
Planning

2021 Year-end tax planning for Puerto Rico individuals

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With the end of 2021 in sight, taxpayers should consider some important tax planning aspects for the upcoming tax filing season.

Filing status

As a general reminder, pursuant to the Puerto Rico Internal Revenue Code of 2011, as amended (the "Code"), there are three ways by which individuals can file their corresponding income tax returns: (i) married; (ii) individual taxpayer; and (iii) married filing separately.

Married couples

- individuals may elect to file one return reporting their combined income, or the optional computation ("split") of tax to avoid higher tax brackets on combined income.
- if prenuptial agreements were filed expressly stipulating that economic regime of "community property assets" is one of complete separation of property, you and your spouse will not qualify for the "married" status for income tax purposes. Consequently, each spouse will be taxed separately as an individual taxpayer.
- if one spouse dies during the year, and the surviving spouse did not remarry in said year, the surviving spouse may file a joint return up to the date of the death, and another as individual taxpayer, from the date of the death up to the end of the year.
- married persons who choose to file separately should include their own income, and certain deductions must be allocated 50% to each spouse and others may be claimed fully by the spouse to whom they relate.

Adjusted gross income

- the Adjusted Gross Income ("AGI") is equal to an individual's total gross income less a series of specific deductions.
- the AGI is a key aspect of tax planning since several tax benefits are tied to or limited by it (e.g., mortgage interests, donations, and medical expenses); therefore, a key aspect of tax planning is to estimate both your AGI for 2020 and 2021.
- when considering whether to accelerate or defer income or deductions, you should be aware of the impact this action may have on your AGI and your ability to maximize deductions that are tied to the AGI. Your 2020 Income Tax Return and your 2021 pay stubs and other income and deduction-related materials are a good starting point for estimating your AGI.

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Collaborated in the preparation of this article.

Regular tax

- for taxable year 2021, the tax determined will be 95% of the total regular tax and gradual adjustment. Also, for taxable years beginning after December 31, 2019, and for individuals with a gross revenue less than 100,001, the tax determined will be 92% of the regular and gradual adjustment, instead of 95%.

- tax rates for ordinary income are:

Net taxable 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%
more than $61,500	33%

Alternate basic tax

- an alternate basic tax in lieu of any other tax will be paid for each taxable year upon the Alternate Basic Tax ("ABT") income of every individual as follows:

ABT income	Tax rate
over from $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%

Optional computation for self-employed individuals

- an optional computation tax is available for self-employed individuals who derive their income substantially from services that are subject to withholding at source. "Substantially" means 80% or more of the services performed.
- tax is computed on gross revenue without the benefit of operating expenses or personal deductions.
- tax must be covered by withholding or estimated tax payments.
- the remain of gross income not attributed to the performing of services (20% or less) shall be taxed at ordinary tax rate.

- tax will be paid for each taxable year upon the optional computation income of every individual as follows:

Optional tax 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%

Retirement savings

- the annual deductible contribution for an IRA for 2021 is $5,000 or the aggregate AGI from salaries and the earnings attributable to professions, whichever is smaller. In case of married taxpayers filing a joint return, the contribution cannot exceed $10,000 ($5,000 for each spouse). One spouse may establish an IRA in the name of the other spouse, whether if the other spouse generates income or not.
- participation in an employer pension plan does not disqualify an individual to make deductible contributions to an IRA.
- if you did not elect the maximum plan contribution for 2021, you can increase your amount for the remainder of 2021 to lower your AGI in order to take advantage of some of the deductions described above and/or lower the tax rate on the year. In addition, maximizing your contribution is generally a good tax-saving move.

Deferring income to 2022 + accelerating deductions into 2021

If you expect your AGI to be higher in 2022 than in 2021, or if you anticipate being in the same or a higher bracket in 2021, you may benefit by deferring income into 2022 and increase deductions in 2021. Deferring income or accelerating deductions may be advantageous if it does not bump your income to the next tax rate bracket in 2022.

In case the deferring income or accelerating deductions is beneficial, some options include:

Charitable contributions

Consider making a large charitable contribution in 2021, rather than in 2022.

Capital gains

If you are considering selling assets that will generate a gain, postpone the sale until 2022 or contemplate investing in an Opportunity Zone Fund. Also, for the sale of certain property you may consider an instalment sale method.

Accelerating income into 2021 + deferring deductions to 2022

If you anticipate being in a higher tax bracket in 2022 or perhaps you need additional income for 2021 to take advantage of an offsetting deduction or credit this tax year. Note, however, that accelerating income into 2021 will be disadvantageous if you expect to be in the same or lower tax bracket for 2022.

If accelerating income/deferring deductions will be beneficial, some options include:

Accelerate collection of accounts receivable

If you are self-employed and report income and expenses on a cash basis, issue bills and attempt collection before the end of 2021. Also, provide an incentive that motivates your clients to pay for January 2022 invoices in advance. A good example is to honor discounts.

Retirement plan distributions

If you are 60 years of age and participate in an employer retirement plan or have an IRA, consider making taxable withdrawals before year-end.

Personal and dependents exemptions

Personal exemptions	Amount
Married	$7,000
Individual taxpayer	$3,500
Married filing separately	$3,500
Exemption for each dependent	$2,500
Veteran's exemption	$1,500

Capital gains

- **short term**: capital gains on property held for one year or less are deemed short-term and will be taxed as ordinary income tax rates.
- **long term**: capital gains on property held for more than one year are deemed long-term and will be taxed at a preferential tax rate of 15%.
- **capital gains invested in opportunity zones**: certain eligible capital gains may be subject to temporary deferral of income tax by timely investing the eligible gain, or a portion thereof, in a qualified opportunity fund. If the investment is held in the qualified opportunity fund for at least 5 years, the basis of the original gain deferred is increased by 10%. An opportunity zone investment may be eligible for this 5-year incentive for timely investments made on or before December 31, 2021, because the statutory tax year to issue applicable payment of the tax on the original gain is December 31, 2026. Furthermore, if the investment is held for at least 10 years, any appreciation of the qualified opportunity fund investment is tax-free.

Capital losses

- capital losses may offset, in the case of a corporation up to 90% of capital gains for taxable years beginning after December 31, 2021. In the case of an individual taxpayer the offset is limited to the lesser of net income or $1,000, with a carryover period of 7 years.

We are committed to keeping you up to date with all tax-related developments. Please contact our Tax Department should additional information be required regarding this or any other tax issue. We will be glad to assist you.

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