



THE POWER OF BEING UNDERSTOOD

PROPOSED BILL FOR TAX REFORM

Year 2015 Issue #5

On February 11, 2015 the House of Representatives presented House Bill 2329 with the purpose of repealing the current Puerto Rico Internal Revenue Code of 2011, as amended, and implementing the Tax Reform that has been constantly discussed these past few weeks. Here are a few highlights of what this Bill proposes:

INDIVIDUALS

- Alternate Basic Tax ("ABT") would be eliminated for Individuals starting with their 2015 Puerto Rico Individual Income Tax Return.
- Special Tax to Self-Employed Individuals of 2% that was applicable in prior years would also be eliminated.
- Earned Income Credit for Salary Taxpayers would be eliminated.
- Income Tax rates for individuals would be as follows.

Taxpayers filing as single, married filing separately and married filing under the Optional method fill have the following rates:

Net Income Subject to Income Tax:	Rate Applicable
No higher than \$40,000	0%
Higher than \$40,000 but not higher than \$125,000	15% of any excess over \$40,000
Higher than \$125,000 but not higher than \$200,000	\$12,750 plus 20% of any excess over \$125,000
Higher than \$200,000	\$22,750 plus 30% of any excess over \$200,000

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PROPOSED BILL FOR TAX REFORM (CONTINUED)

Taxpayers filing as married not filing under the Optional method fill have the following rates:

Net Income Subject to Income Tax:	Rate Applicable
No higher than \$80,000	0%
Higher than \$80,000 but not higher than \$125,000	15% of any excess over \$80,000
Higher than \$125,000 but not higher than \$200,000	\$6,750 plus 20% of any excess over \$125,000
Higher than \$200,000	\$21,750 plus 30% of any excess over \$200,000

INDIVIDUALS

- The Special Deduction for certain individuals with less than \$20,000 in salaries would be eliminated.
- Certain deductions would be eliminated by this Bill. The following is a list of deductions that are currently allowed and which ones would be allowed if this Bill is enacted:

Deductions under the Puerto Rico Internal Revenue Code of 2011, as amended	Deductions under the Proposed Bill
Mortgage Interest	Charitable Donations
Charitable Donations	Medical Expenses
Medical Expenses	Interest on Student Loans
Interest on Student Loans	Contributions to Governmental Pension Plans
Contributions to Governmental Pension Plans	Contributions to Individual Retirement
Contributions to Individual Retirement Accounts (IRAs) and Educational IRAs	
Contributions to Health Savings Accounts	
Losses due to Natural Disasters	

PROPOSED BILL FOR TAX REFORM (CONTINUED)

- Personal Exemption of \$3,500 per taxpayer would be eliminated.
- Deduction for dependents would also be eliminated.
- Additional personal exemption for veterans would be eliminated.
- Preferential tax rates available to individuals under prior rules of 15% on long term capital gains and dividends would now be increased to 30%, or normal tax rates, whichever is lower for the taxpayer.
- The Cost of Living Adjustment ("COLA") received by employees of the Federal Government that work in Puerto Rico would no longer be an exemption from gross income.
- Exemption on Rental Income from properties located in Historical Zones, pursuant to Act 7 of 1955, as amended, will be limited to those rental agreements entered into prior to February 16, 2015.
- The deduction for prior period capital losses carried forward would be limited to 90% of current year long term capital gains.
- A new tax credit would be granted to certain taxpayers who have a mortgage on their "qualified" residential property.

CORPORATIONS

- Corporate income tax rates would be changed from a 20% normal rate plus surtax of up to 19%, resulting in a potential maximum rate of 39%, to a flat 30% rate.
- Surtax deduction of \$25,000 would be eliminated, since the surtax would no longer be applicable.
- The Additional Tax on Gross Income, known as "Patente Nacional", would be eliminated by this Bill.
- Alternative Minimum Tax ("AMT") would be modified in the following manner:
 - Regular AMT rate would be reduced from 30% to 25%.
 - Inventory purchased from related parties would be subject to an AMT rate of 1.5%, except in the following industries:

Alcoholic Beverages subject to Subtitle E	0.375%
Gasoline and Crude Oil	0.375%
Motor Vehicles	0.250%

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Please contact us here at RSM where we are prepared and committed to answer all your inquiries related to these new rules.

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PROPOSED BILL FOR TAX REFORM (CONTINUED)

- Please note that this Bill does not contemplate granting reductions to these rates for taxpayers that can prove to the Secretary of the Treasury that the purchase of inventory from related party is being made at arm's length or market value.
- All waivers from previous rules issued for Alternative Minimum Tax purposes will not be valid for years commencing after December 31, 2014.
- Intercompany expenses that were allowed as a deduction for regular income tax purposes (subject to the 51% disallowance rule) would be added back to arrive at Income Subject to AMT, as an adjustment. Currently, businesses must calculate a 20% AMT on this amount. The Secretary of the Treasury would no longer be empowered to waive this requirement to taxpayers that can prove a reasonable allocation method.
- Preferential tax rates on long term capital gains and dividends would be increased from 20% to 30%.
- Accelerated Depreciation would not be allowed under this Bill.
- Corporations would now be allowed to elect pass-through treatment for income tax purposes.
- This Bill proposes a Value Added Tax ("VAT") on most goods and services.
- The proposed rate is 16% and would be expected to commence on January 1, 2016. This tax would substitute the current Sales & Use Tax ("SUT").
- Transactions subject to VAT after December 31, 2015 would include:
 - Import and/or Introduction of Goods into Puerto Rico.
 - Sale or transfer of Goods and Services provided by a Merchant in Puerto Rico.
 - Services provided by a non-resident person to a person in Puerto Rico.
 - Combined Transactions.
- Transactions not subject to VAT:
 - Sales of Goods for Export.
 - Export of Services, or services provided outside of Puerto Rico.
 - Raw materials imported into Puerto Rico by a Manufacturing Plan with a valid Exemption Certificate.
- There are some other goods and services that would be exempt from VAT including, but not limited to:
 - Financial Services.
 - Prescription Drugs.
 - Sale of articles and equipment to compensate for physical or physiological deficiencies of disabled persons.
 - Sale of any equipment or service that qualifies for total or partial reimbursement from Medicare, Medicaid and the health insurance card of the Government of Puerto Rico.
 - Sale of goods and services to the Government of Puerto Rico and the Government of the United States, including any State.
 - Sale of gasoline, aviation fuel, gas oil or diesel oil, crude oil, partially finished and finished derivative products and any other blend of hydrocarbon, except propane gas and its byproducts or gases of similar nature.
 - Lease of any property subject to the room occupancy tax fixed by the Puerto Rico Tourism Company.

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PROPOSED BILL FOR TAX REFORM (CONTINUED)

- Sale and import of food and food ingredients.
 - Sale of items acquired with funds received under the Federal Nutrition Assistance Program (PAN) or under the Special Supplemental Nutrition Program for Pregnant Women, etc. (known as WIC).
 - Sale of real property.
 - Rental of real property that constitutes the principal residence of the lessee or student lodge.
 - Transfer of good or services provided by a duly qualified Not-for-profit organization, without any charge or consideration.
 - Sale of machinery, medical-surgical material, supply, article, equipment and technology used to render health services.
 - Sale and import of articles and equipment by bona fide farmers.
 - Sporadically sales of goods by churches and religious organizations.
 - Sale of goods and services used in a touristic activity by a business covered under the benefits of the Puerto Rico Tourism Development Act of 2010.
 - Sale and import of motor vehicles.
 - Services rendered between related parties.
- Under the VAT regime, there would be several certificates including:
 - Merchant Registration Certificate – Issued to any person doing business in Puerto Rico
 - Registration Certificate for Small Businesses – will be issued to any merchant with annual gross sales lower than \$75,000.
 - Certificate for Exempt Purchases – will allow an eligible person to purchase goods and/or services exempt from VAT. For this purpose, and eligible person is defined as:
 - Government of Puerto Rico, Government of the United States and any State.
 - Hospital units.
 - Business dedicated to a tourist activity.
 - Bona fide farmers.
 - Certificate of Exemption on imports by Eligible Manufacturing Plants – will allow a manufacturing plant to import raw material without paying VAT.
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 - Eligible Merchant Certificate – will be issued, subject to certain conditions, to merchants with gross revenues in excess of \$500,000 and with 80% or more of its total sales subject to 0% VAT.
 - The VAT regime will require certain returns that include:
 - Every merchant must file a "Monthly VAT Return on Imports" by the 10th of the month following any import of goods.
 - Every merchant, except the ones with a valid "Registration Certificate for Small Business", must file a "Monthly VAT Return for Goods and Services" by the 20th of the month following the withholding of the VAT.
 - Every merchant with a valid "Registration Certificate for Small Business" must file an Annual VAT Informative Declaration to report the total amount of sales and services for the year. This return will be due 60 days after the due date for filing the merchant's income tax return.

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- The VAT regime will grant businesses the ability to claim credits for VAT paid on the merchant's goods and services purchased. This includes:
 - Every merchant, except the ones with a valid "Registration Certificate for Small Business", can claim a full credit for the amounts of VAT paid related to the sale of goods or rendering of services.
 - The credit must be claimed in the Monthly VAT Return for Goods and Services.
 - In order to claim the credit, the amount of VAT paid must be reflected in the "Tax Receipt" issued by the service provider or the person selling the goods.
 - Any overpayment of VAT lower than \$10,000 must be carried forward to next month. Any overpayment in excess of \$10,000 can be claimed as a refund subject to certain conditions.
- There would be a transition clause for the VAT system where the tax rate for the current Sales & Use Tax will be increased to 16% for any transaction that takes place between April 1, 2015 through December 31, 2015.

Please note that these are proposed changes and that during the legislative process these proposed changes highlighted by us may be significantly different if approved than we have presented in this Tax Alert. You should not rely on this information to make any business or tax decisions until this Bill is final and it has been signed into Law.

We will continue to monitor the progress of this Bill and will keep you informed of any development that becomes available to us. If you have any questions or comments, please feel free to contact your tax advisor.

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