



THE POWER OF BEING UNDERSTOOD

ACT 257: PUERTO RICO TAX REFORM OF 2018

Year 2018 Issue #7

Introduction

On December 10, 2018 the Governor of Puerto Rico signed into Law Act 257 to amend some of the provisions of the Puerto Rico Internal Revenue Code of 2011, as amended. Act 257 introduces various changes to our current tax regime in the case of Individuals, Corporations and Sales and Use Tax. Following a summary of some of the changes brought by this new Act:

I. Individuals

Normal Tax: Act 257 establishes that for taxable years started after December 31, 2018, the tax liability determined will be 95% of the amount determined for regular tax and gradual adjustment. In other words, the tax tables will remain the same as in 2018 and the tax liability will be calculated as usual. However, a credit of 5% of the tax liability determined will be applicable, thus effectively reducing the amount to 95% of the amount determined.

Alternative Basic Tax: Act 257 modifies the income threshold for the Alternative Basic Tax ("ABT"). The current tax regime imposes a tax rate between 10% to 24% for individuals with a net income subject to ABT of \$150,000 or more. Under the new law, the new income threshold for the ABT would be as follows:

Net Income Subject to Alternative Basic Tax	Tax Rate
In excess of \$25,000, but less than \$50,000	1%
In excess of \$50,000, but less than \$75,000	3%
In excess of \$75,000, but less than \$150,000	5%
In excess of \$150,000, but less than \$250,000	10%
In excess of \$250,000	24%

Certain limitations are established to claim deductions for ABT purposes; however, any individual who submits an Agreed Upon Procedure or a Compliance Attestation Report with their tax return, will be allowed to claim a deduction for all ordinary and necessary expenses related to its trade or business in the calculation of the net income subject to ABT.

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Gradual Adjustment: A 5% gradual adjustment would apply on net income in excess of \$200,000, up to a maximum gradual adjustment amount of \$13,273.

Optional Tax for Self-Employed Individuals: An Optional Tax is introduced to self-employed individuals whose source of income is substantially derived from services subject to withholding tax. The Optional Tax would allow the self-employed individual to pay a fixed tax rate on the gross income received, as long as the income generated by self-employment is subject to withholding at source in its entirety and have been duly informed in the corresponding informative return. The fixed tax rates and income thresholds subject to the Optional Tax are as follows:

Gross Income	Tax Rate
Less than \$100,000	6%
In excess of \$100,000, but less than \$200,000	10%
In excess of \$200,000, but less than \$300,000	13%
In excess of \$300,000, but less than \$400,000	15%
In excess of \$400,000, but less than \$500,000	17%
In excess of \$500,000	20%

Earned Income Tax Credit (EITC): Act 257 introduces a refundable EITC that varies from \$300 to \$2,000, applicable to certain resident taxpayers with earned income.

II. Corporations

Normal Tax: Act 257 reduces the maximum normal tax rate for corporations from 20% to 18.5%. The surtax is still applicable to Corporations under the same rules as in previous years, as such, the maximum tax rate applicable to Corporations for the year 2019 onwards is 37.5%.

Alternative Minimum Tax ("AMT"): Under the Act 257, the AMT for corporations would be the greater of \$500 or 18.5% of the net income subject to AMT. Corporations with a volume of business in excess of \$3,000,000 would be subject to a 23% AMT rate.

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Act 257 establishes certain limitations to claim deductions for AMT purposes, however, corporations that file Audited Financial Statements, an Agreed Upon Procedure or a Compliance Attestation Report with the Secretary of the Treasury, will be allowed to claim a deduction for all ordinary and necessary expenses related to the trade or business in the calculation of the net income subject to AMT.

Optional Tax for Corporations Engaged in Rendering Services: An Optional Tax is introduced to corporations with gross income substantially derived from the rendering of services. The Optional Tax would allow these corporations to pay a fixed tax rate on the gross income received, as long as the income generated is subject to withholding at source in its entirety and have been duly informed in the corresponding informative return. The fixed tax rates and income thresholds subject to the Optional Tax are as follows:

Gross Income	Tax Rate
Less than \$100,000	6%
In excess of \$100,000, but less than \$200,000	10%
In excess of \$200,000, but less than \$300,000	13%
In excess of \$300,000, but less than \$400,000	15%
In excess of \$400,000, but less than \$500,000	17%
In excess of \$500,000	20%

III. Partnerships

Sale of Partnership Interest: Under Act 257, any gain on the sale of a partnership interest would be considered Puerto Rico source income, regardless of the partner's residence, if such partnership would have generated Puerto Rico source income from the sale of the partnership's assets. In addition, the sale will be subject to a 15% withholding at source.

IV. Other Income Considerations

Fifty-one Percent (51%) Disallowance: Taxpayers who file a Transfer Pricing Study with the Secretary will be released from the 51% disallowance on intercompany expenses paid or incurred.

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Net Operating Loss Deduction: The net operating loss deduction increases from 80% to 90%.

Meals and Entertainment: For taxable years commencing after December 31, 2018, the allowed Meals and Entertainment deduction will be limited to 25% of the amount incurred, instead of the 50% under the current dispositions.

Travel Expenses: For taxable years commencing after December 31, 2018, the allowed travel expense deduction will be limited to 50% of the amount incurred.

Wages Paid to College Students: Employers may be able to claim a deduction of 150% of the amount of wages paid to college students, under certain circumstances.

Large Taxpayer Definition: Act 257 expands the definition of "Large Taxpayer" to include International Insurers. Also, in order to determine the \$50,000,000 threshold, the aggregated volume of all related entities as defined by the Code need to be considered. Finally, the taxpayer may request to the Secretary of the Treasury to be excluded from these dispositions.

Withholding on Services Rendered: The required withholding amount on payments made for services rendered increases from 7% to 10%. Act 257 reduces the withholding exemption on the first \$1,500 to \$500 on payments for services rendered. Also, the due date to deposit the amounts withheld will be the 15th day of each month.

Requirement to File Informative Returns: Taxpayers who fail to file informative returns to report payments will not be allowed to claim the corresponding deduction on the Income Tax Return.

V. Sales and Use Tax ("SUT")

Services rendered between merchants: Effective March 1, 2019, services rendered between merchants that do not exceed the \$200,000 are exempt from the SUT (considering volume of business generate in the previous year).

Applicable SUT to Prepared Food: A reduced SUT rate of 7% will be applicable to the sale of prepared food effective on October 1, 2019. The reduced rate will apply to transactions regardless of the payment method used.

At RSM Puerto Rico we are ready to help you with these matters. If you have any questions or comments related to the content of this Tax Alert, please feel free to contact your Tax Advisor at RSM Puerto Rico.

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