

December 29, 2014

Tax Update

Despite the Holiday Season, the past weeks have been intense with legislation affecting taxation in Puerto Rico. In this Tax Update, the last of 2014, as briefly as possible we summarize the most relevant provisions of several of the recently enacted laws. More bills are pending signature by the Governor of Puerto Rico, thus we anticipate more activity early in 2015.

In the meantime, receive our best wishes for a prosperous New Year!

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Act 239-2014 Introduces Technical Corrections to the Puerto Rico Internal Revenue Code of 2011, Extends the Due Date for Certain Tax Prepayments and a Sunset Provision to the Additional Tax on Gross Income

Background for Act 239-2014

On July 1, 2014 Act No. 77-2014, known as the Tax System Adjustments Act, substantially amended the Puerto Rico Internal Revenue Code of 2011 ("Code"). Following are some of these amendments:

1. Payment of certain taxes at reduced tax rates during the period from July 1, 2014 through October 31, 2014:
 - a. Payment by an individual, estate or trust of the special tax on the sale of long term capital assets ("LTCA") or prepayment of the special tax



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on the increase in value of certain other assets at a reduced tax rate of 8% in the case of capital assets and 15% in the case of certain “included assets” otherwise taxed at regular rates.

- b. Payment by corporations of the special tax on the sale of LTCAs or prepayment of the special tax on the increase in value of such LTCAs at a reduced tax rate of 12%.
 - c. Prepayment by individuals of a special tax of 8% on all or part of any accumulated and undistributed balance of an individual retirement account (“IRA”). It also increased the penalty for early withdrawal of prepaid amounts of an IRA by a beneficiary under 60 years of age from 10% to 30%.
2. Effective July 1, 2014, the special tax rate on long term capital gains (“LTCG”) was increased, in general, from 10% to 15% for individuals, estates and trusts, and the alternative tax on LTCG for corporations increased from 15% to 20%.
 3. Effective July 1, 2014, the long term holding period for capital assets in computing LTCG or losses is increased from six months to one year.
 4. The additional tax on gross income (“Patente Nacional”) would, for taxable years beginning after December 31, 2013, be imposed by a new Section 1023.10A and would no longer be a part of the Alternative Minimum Tax, but a separate tax payable by all legal entities including corporations (or entities taxed as corporations), partnerships (or entities taxed as partnerships) and other pass through entities.

Amendments Made by Act 239-2014

Act 239-2014 introduces important changes and additional technical amendments to the Code. Following are the most relevant amendments.

Extension of Tax Prepayments Deadlines

The period to pay or prepay the abovementioned taxes at reduced tax rates was extended until **January 31, 2015**.

Act 239-2014 further clarifies that:

1. The special tax rate of 8% referenced in 1.a., above, applies to any amount accumulated under a qualified retirement plan.
2. The special tax rate of 15% further applies to amounts distributed from non-qualified retirement plans established before November 1, 2014.

Act 239-2014 also reduces the penalty for early withdrawal of prepaid amounts of an IRA by a beneficiary under 60 years of age from 30% to 15%. This penalty, however, is not applied on amounts withdrawn to make the prepayment of taxes at the reduced 8% rate.

Additional Tax on Gross Income

The changes made to the Code with the introduction of Section 1023.10A and modifications to Section 1023.10 by Act 77-2014 produced certain timing differences in situations where partnerships (or entities taxed as partnerships) and other pass through entities with fiscal taxable years commenced after January 1,

2013 have owners, members or shareholders (who, in turn, were responsible for the payment of the tax as originally imposed by Section 1023.10) with a different taxable year. To address such situation, Act 239-2014 introduced transitory provisions applicable to partnerships (or entities taxed as partnerships) and other pass through entities with fiscal taxable years commenced after January 1, 2013 and ending on or before November 30, 2014. Such entities are required to file, **on or before January 31, 2015**, a “Supplemental Return for the Calculation of the Additional Tax on Gross Income”, which will reconcile amounts paid by the entity and withholdings made to its owners, members or shareholders.

Act 239-2014 further limited the application of the Additional Tax on Gross Income of Section 1023.10A so that it **will not be imposed for taxable years commenced after December 31, 2014**.

Introduction to Puerto Rico

Act 80-2014 added a definition of “introduction” in paragraph (aaa) of Section 4010.01 of the Code to state that tangible personal property introduced to a Foreign Trade Zone (“FTZ”) would be considered introduced to Puerto Rico upon arrival to the FTZ for purposes of sales and use taxation.

Act 239-2014 amended the definition of the term “introduction” to provide that tangible personal property that arrives to Puerto Rico but is stored in a FTZ, shall be treated as introduced to Puerto Rico when such items either leave the FTZ or are deemed introduced to the U.S. customs territory according to U.S. federal regulations. This fact shall be evidenced by the presentation of Form 214 “Application for Foreign-Trade Zone Admission and/or Status Designation”.

Use Tax

The following events will not trigger use tax liability: (i) the mere storage, custody, retention or retirement from a warehouse of personal property by a person that manufactures, process, or assembles such personal property and (ii) the storage or consumption of a taxable item by a person that paid use tax on such item upon introduction to Puerto Rico.

Incentive to Pay Traffic Tickets

A partial amnesty is enacted to encourage the payment of traffic tickets. Under this program, and during the 90 day term thereof, Puerto Rico license holders shall be able to pay their traffic tickets with a 35% discount at any of the Department of Transportation and Public Works’ centers, Puerto Rico Treasury collection offices (“colecturías”), banks, credit unions, municipalities or other centers authorized to sell digital stamps.

The Department of Transportation and Public Works shall adopt regulations to manage the program by March 22, 2015 and the discount will be available for a period of 90 days after such regulations are in force.

Act 203-2014 Amends Act 73-2008 (the Economic Incentives Act for the Development of Puerto Rico) to Include a New Eligible Activity and Extend Pioneer Tax Rates

Act 203-2014 included the development and improvement of industrial products or processes for the aerospace industry (including the aeronautical engineering field) as an eligible activity. It also amends Act 73-2008 to allow existing businesses with exempt operations under Act 135-1997 to enjoy the same fixed tax rate as under

their Act 135 grant on industrial development income, even when such rate is less than 2%.

Act 206-2014 Amends the Code to Impose Aviation Fuel Excise Taxes on Importers Instead of Fuel Suppliers

Section 3020.06 of the Code is amended to state that the fee of 2 cents per gallon, or fraction thereof, currently imposed on aviation gasoline and other fuel products used or consumed by air transportation vehicles will be collected from the importers of such fuel rather than from the suppliers operating in the Puerto Rico airports.

Act 206-2014 further establishes that the importer shall pay such fee prior to taking possession of the products, unless the importer has a bond in place, in which case the payment may be made no later than the 10th day of the month following the month in which the importer takes possession of the products.

Act 220-2014 Streamlines Requirements to Qualify as an Eligible Reseller and Increases the Sales and Use Tax Credit

Act 220-2014 amends the Code to authorize the Secretary of Treasury to classify a merchant whose withdrawal from inventory for resale to exempt persons is less than 80% as an eligible reseller. Moreover, it classifies merchants that constitute a program of voluntary chain of retailers of goods and services organized under the provisions of Act 77-1964, or a program under a similar structure pursuant to Act 239-2004 as eligible resellers without having to comply with the 80% requirement.

Act 220-2014 also amends the Code to allow merchants that are principally dedicated to the sale of unprepared foods and “provisions or supplies” (term undefined in the Code) to claim a credit for the amount of sales or use tax paid on the purchase or introduction of taxable items for resale of up to 100% of the tax liability reflected on their Sales and Use Tax Return corresponding to the period for which such tax was paid.

Act 211-2014 Extends the Sales and Use Tax Exemption to Bottles, Caps, Labels and Bags Used to Dispatch Prescription Drugs

Act 211-2014, effective December 16, 2014, grants sales and use tax exemption to bottles, caps, labels and bags used to dispatch prescription drugs. The Puerto Rico Treasury Department is ordered to modify its regulations accordingly by March 16, 2015.

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