

## *Opportunity for Nonprofit Entities without Tax Exemption - Action required on or before June 30, 2012*

Last March 14<sup>th</sup>, the Puerto Rico Treasury Department issued Internal Revenue Circular Letter No. 12-03 (“CC 12-03”) addressed to all nonprofit entities. This circular letter deals with certain provisional measures established by Act 232-2011 which provides for technical amendments to the New Code.<sup>(1)</sup> This article summarizes the provisional measures applicable to nonprofit entities that have not requested an income tax exemption Ruling to the Secretary of the Treasury (“Provisional Measures”).

### **Background**

Section 1101.01 of the New Code (applicable for taxable years commencing on January 1, 2011 and thereon) as originally enacted established, among other things, that nonprofit entities “shall commence to enjoy the tax exemption benefit starting on the first day of the organization’s taxable year in which it filed the application for tax exemption before the Secretary [of the Treasury]. Nevertheless, the effective date provided herein shall never be before the date when the nonprofit entity was legally organized or was registered at the Department of State.”<sup>(2)</sup> (Emphasis added and our English translation.)

For many nonprofit entities that did not have a tax exemption Ruling approved by January 1, 2011 (many of them due to not filing the application for tax exemption), the above meant that the Secretary of the Treasury would not grant the tax exemption retroactively (for years prior to the filing of the request for a tax exemption).<sup>(3)</sup> This in turn would have resulted in a taxable treatment for all taxable years ended before the taxable year which the application for tax exemption was filed and, therefore, any surplus generated during those years would have been subject to income tax. In addition, the lack of tax exemption would have impacted other taxes such as the municipal license and the personal and real property taxes.

### **Opportunity - CC 12-03**

The Provisional Measures enacted by Act 232-2011 provide that “in the case of nonprofit entities that as of the effective date

*Continues on Page 2*

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**Opportunity for Nonprofit Entities...**

**Continued from Page 1**

of this Code have not obtained a Ruling from the Secretary [of the Treasury] approving a tax exemption under the provisions of Section 1101 of Act 120-1994, as amended, known as the "Puerto Rico Internal Revenue Code of 1994", may apply for retroactive tax exemption to the entity's organization date as the effective date of such tax exemption, if the entity is up to date on its tax responsibilities and meets the requirements established by this Section. This application must be submitted not later than June 30, 2012."(4) (Emphasis added and our English translation.)

CC 12-03 clarifies, among other things, that "to be up to date with its tax responsibility" means that the entity has filed its income tax returns,(5) employer's returns and informative returns (as those applicable upon the payment of certain professional services) in addition to not owing any payroll taxes (including the 7% withholding applicable to certain payments for professional services). If the entity has any debts with the Treasury Department, these must be covered under a payment plan.

In terms of the compliance with the income tax returns filing, CC 12-03 provides a unique opportunity if the entity has not filed such returns since it allows the entity to file its informative returns for tax exempt organizations (Form 480.70 (OE)) for the last five years

and include copies with its application for tax exemption. In addition, it states that if the entity has filed its previous income tax returns as a taxable entity without claiming tax exemption under Section 1101 of Act 120-1994, even though it may not file a request for refund for any income tax paid with such returns, any income tax debt related with its exempt activities shall be waived once the tax exemption is approved.

**Nonprofit entities with tax exemption under the provisions of Section 1101 of Act 120-1994**

- a. In general.- CC 12-03 provides that all tax exempt entities must file by June 30, 2012, a sworn statement signed by the president of the board of directors or the entity's chief executive officer certifying that the entity complies with the board of directors' composition requirement.(6) This sworn statement must be filed at the Tax Exemption Division of the Treasury Department and must include a list with the names, addresses, titles and social security numbers of each member of the board.
- b. Those that have a ruling granting tax exemption but that as of January 1, 2011 do not meet the requirements established under the New Code to nonprofit entities. – CC 12-03 reminds that as part of the technical

amendments to the New Code these entities may file for a new ruling under the New Code as long as they are able to demonstrate that they now meet such requirements.

**Comments**

Those nonprofit entities that as of today do not have a ruling for tax exemption issued by the Treasury Department, must take immediate action and verify if their activities may qualify for exemption to file for an application by June 30, 2012. On the other hand, those who have an approved tax exemption Ruling previous to the New Code must verify the compliance with the new requirements. Doing nothing may result in the revocation of the existing tax exemption Ruling and the imposition of income, real and personal property taxes as well as municipal license taxes (in addition to any applicable interest and penalties).

We have the experienced and qualified personnel required to address this and many other matters concerning nonprofit entities. Contact us to determine if CC 12-03 is applicable to your nonprofit institution or if you need assistance in obtaining any document required to be included with the application for tax exemption (such as bylaws, certificates of debts, financial forecasts and merchants' registry).

**Notes:**

- (1) Act 1-2011.
- (2) (2) Section 1101.01(d)(1) of Act 1-2011 as approved in its original

version without amendments.

- (3) In general terms and assuming that the entity is engaged in an activity that qualifies for tax exemption. In addition, certain entities, like churches, may still apply for tax exemption with its commencement of operations as the effective date for exemption.
- (4) Section 1101.01(f) of the New Code as amended by Act 232-2011.
- (5) Most of the entities exempt under Section 1101 of Act 120-1994 are required to file an informative return for income tax exempt organization at the Treasury Department on a yearly basis (using Form 480.70(OE)).
- (6) Section 1101.01(d)(2) of the New Code states that the board of directors must be composed of no less than three (3) members of which less than fifty (50) percent can be from the same family circle as that of the person who organized, or is one of the chief executive officers of, the entity or that is the chairperson of the board of directors.

**Continues on Page 3**

**Opportunity for Nonprofit Entities...**  
**Continued from Page 2**

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