

Update on the Deduction of Automobile Expenses

In our December 2010 Special Bulletin of The Tax Advisor (the "Special Bulletin") we analyzed the implications of House Bill 3070, which proposed to establish a new Internal Revenue Code including, among other changes, limitations on the deductibility of expenses related to the use of automobiles in businesses.

Since then, the Government of Puerto Rico signed into law the Internal Revenue Code for a New Puerto Rico, as amended (the "Code") with several changes to House Bill 3070, and the Puerto Rico Treasury Department ("Treasury") issued proposed regulations as well as Administrative Determination 12-06 ("AD 12-06") in connection to this matter. Accordingly, the purpose of this article is to provide you with a summary of the most important provisions contained in the Code, AD 12-06 and the proposed regulations in regards to the aforementioned deduction.

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Section 1033.07(a)(3)(G) of the Code provides for the disallowance of the deduction related to those expenses incurred or paid for the use and maintenance of an automobile, including but without limitation to repairs, insurance, maintenance, gasoline and related expenses. In lieu of such expenses actually incurred or paid, this Section establishes a deduction for the use of an automobile to carry out the trade or business, determined on the basis of a standard mileage rate. At the time of the approval of the Code, Section 1033.07(a)(3)(G) provided that the Secretary of the Treasury ("Secretary") was to determine by regulations the standard mileage rate applicable to each taxable year. However, as of today no regulations have been approved related to this deduction. It is also pertinent to mention that the proposed regulations, as explained below, establish that the above will not apply to those taxpayers that elect to compute their income tax liability and file the 2011 return and the subsequent return for the next four (4) years pursuant to the provisions contained on the Puerto Rico Internal Revenue Code of 1994, as amended.

As previously stated on our Special Bulletin, for purposes of the provisions of Section 1033.07(a)(3)(G) of the Code, the term automobile is defined as any vehicle manufactured principally to be used in the public streets, highways and avenues, provided with any means of self-propulsion which may have been designed for transporting persons, except for:

- I. Automobiles used directly in the business of transporting passengers or property for compensation or payment such as limousines, taxis or public vehicles.

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2. Hearses, wreath carriages, omnibuses, ambulances, motorcycles, trucks, vans and any other similar vehicle used principally in the transportation of cargo.
3. Automobiles lease or possessed for leasing to persons regularly engaged in automobile leasing.

On December 22, 2011, Treasury published proposed regulations to Section 1033.07(a)(3)(G) of the Code. The proposed regulations established the requirements to determine the deductions for expenses incurred or paid for the use and maintenance of an automobile based on the actual mileage the automobile was used as part of the trade or business multiplied by a standard mileage rate. The proposed regulations also included definitions of what is "an automobile" for purposes of this deduction, what are the expenses considered as "for the use and maintenance of an automobile" and the information needed to support the actual expense deduction. However, the proposed regulations were not well received by the tax and business community due to the additional burden imposed on the taxpayer in the computation of the mileage and the fact that it did not provide transition rules for the period from the signing of the Code to the effective date of the proposed regulation, among others. As of today, the proposed regulations have not been finalized by Treasury.

To provide some guidance on the issue, Treasury issued

AD 12-06 on March 14, 2012. AD 12-06 takes on some of the requirements and definitions in the proposed regulations and adds some transition rules. In effect, AD 12-06 is serving as the "de facto" regulation until the proposed regulations are finalized and become effective.

AD 12-06 provides two alternatives to compute the amount to be deducted for expenses related to the use and maintenance of automobiles:

1. Expenses computed based on a Standard Mileage Rate ("SMR") of sixty cents (\$0.60) per each mile the taxpayer uses in its trade or business or for the production of revenues.
2. Actual expenses incurred for the use and maintenance of an automobile in a trade or business or for the production of revenues, including those expenses that are duly documented by the employees under a reimbursement plan established by the employer.

AD 12-06 further provides that a deduction for actual expenses for the use and maintenance of an automobile shall be allowed as long as such expenses were incurred on or before June 30, 2012. Therefore, expenses incurred **from July 1, 2012 on** will be determined exclusively based on the SMR. In addition, please be advised that the current SMR will be effective until the Secretary changes the rate by way of regulations or any other public determination issued to that effect.

The deduction for expenses

related to the use and maintenance of automobiles, either determined based on the current SMR or the actual expenses incurred, includes among others, the following expenses:

- gasoline;
- repairs;
- oil and filter change;
- car wash;
- tires;
- insurance;
- annual license rights ("marbete");
- any other routine maintenance expense.

Please bear in mind that the deduction for expenses related to the use and maintenance of automobiles does not take into consideration the allowable deduction for depreciation contained on Section 1033.07(a)(3)(A) or the allowable deductions for operating or financing leases of automobiles contained on Sections 1033.07(a)(3)(E) and 1033.07(a)(3)(C) of the Code, respectively. In both cases, it will be allowed as a deduction in accordance with the rules established in the Code. Also, it is imperative to clarify that the SMR does not include payments for parking use or toll expenses. These expenses shall be deductible as miscellaneous expenses.

For purposes of the necessary documentation to sustain and support any deduction computed according to the current SMR, deductions based on an estimated mileage will not be allowed, and the taxpayer must keep adequate and itemized records. Any taxpayer that claims the deduction for expenses related to the use and maintenance of an automobile pursuant to the current SMR shall keep a mileage diary, which must include the following

information:

- date;
- place or destiny of that specific trip;
- business or purpose of the trip;
- odometer reading before and after the trip;
- the number of miles traveled for purposes of the trade or business or

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for the production of revenues;

- the number of miles traveled for personal use;
- the total miles traveled during the year.

Finally, we have been apprised that, apparently, Treasury is seriously considering postponing the effectiveness of the rules examined herein in terms of

the allowance for the deduction for business automobile expenses actually paid or incurred until December 31 instead of June 30, 2012.

Z&A COMMENTS:

Both the proposed regulations and AD 12-06 provide a methodology which requires the taxpayers to keep very detailed and exact information of the mileage they incur in both business and personal travels.

From July 1, 2012 on, keeping such information is a requirement in order for the taxpayer to be able to deduct the automobile expenses mentioned above. Although not mentioned in AD 12-06, the proposed regulations also establish that the SMR methodology is a requirement in order to compute the depreciation deduction attributed to the business use of the automobile. Therefore, businesses should seriously consider establishing the

SMR methodology provided in AD 12-06 and the proposed regulations right away to avoid any possible disallowance of deductions by Treasury.

We will inform you of any new development in connection to the possible extension of time and the issuance of the final regulations.

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