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Recent Changes to the 2010 Income Tax Return and the New Voluntary Disclosure Program

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On November 15, 2010 the Governor of Puerto Rico, Hon. Luis G. Fortuño, signed Acts 171 and 172 which are part of the 2010 Tax Reform. In the following article, we will explain the main provisions of both acts.

ACT 171 OF NOVEMBER 15, 2010 ("ACT 171")

Act 171 includes several provisions that apply to individuals, corporations and partnerships. Let's start with the most important provision of Act 171: the tax credit that would reduce the income tax liability for taxable year 2010.

Additional Tax Credit for Taxable Year 2010

New Section 1040N of the Puerto Rico Internal Revenue Code of 1994, as amended (the "Code") includes an additional tax credit available to individuals and corporations for taxable year 2010. In the case of an individual that generates adjusted gross income comprised of salaries, compensation for services rendered, pensions, annuities or any other income of similar nature he/she may claim a credit to offset the income determined by Subtitle A of the Code, as follows:

ADJUSTED GROSS INCOME	CREDIT AGAINST TAX DUE
Not more than forty thousand dollars ($40,000).	Fifteen percent (15%) of the tax due.
In excess of forty thousand dollars ($40,000) but not in excess of one hundred thousand dollars ($100,000) (one hundred fifty thousand dollars ($150,000) in the case of married persons filing jointly and that do not choose the optional computation of Subsection (d) of Section 1011).	Ten percent (10%) of the tax due.
In excess of one hundred thousand dollars ($100,000) (one hundred fifty thousand dollars ($150,000) in the case of married persons filing jointly and that do not choose the optional computation of Subsection (d) of Section 1011).	Seven percent (7%) of the tax due.

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The "Tax Due" referred to above would be reduced by various tax credits provided in the Code before computing the additional tax credit. In addition, the additional tax credit cannot reduce preferential tax rates and the alternate basic tax.

For corporations and partnerships, the additional tax credit applies for taxable years beginning after December 31, 2009 and before January 1, 2011. Every corporation and partnership subject to the regular tax rates provided by the Code may take a seven percent (7%) credit to reduce its tax due. In order to be eligible for tax credit, the corporation or partnership must comply with the payment of the Christmas bonus in accordance with the "Christmas Bonus Act, as amended."

As in the case of individuals, the Tax Due would be reduced by various tax credits. It should be noted that in both cases, individual and corporations, the "Tax Due" referred to above would be reduced by tax credits available to the taxpayer before computing the additional tax credit. This means that many purchasers of tax credits will not see the benefit of the discount of such purchase as a result of this provision. For instance, a buyer of a tax credit at ninety three percent (93%) (i.e., purchased at a seven percent (7%) discount) will not get any benefit for taxable year 2010 as a result of the computation of the seven percent (7%) additional tax credit.

Also, the credit cannot reduce preferential tax rates, or tax rates imposed by tax incentives acts nor the corporate alternative minimum tax.

Net Operating Loss Deduction

The net operating loss carryover period is increased from seven to ten years for taxable years started after December 31, 2004 and before December 31, 2012.

Depreciation and Amortization Deductions

In computing the accelerated depreciation deduction and when the Code does not provide depreciation periods for some tangible property, taxpayers may use the terms provided by the U.S. Internal Revenue Code and the Regulations thereunder until the Secretary of the Treasury approves new regulations. Furthermore, intangible property, that does not constitute goodwill and that is acquired by purchase or developed, may be amortized using the straight line method and a useful life of fifteen (15) years or the useful life of such intangible property, whichever is less.

On December 21, 2010, the Secretary of the Treasury issued Internal Revenue Circular Letter Number 10-09. This circular letter clarified that the above provisions related to depreciation and amortization of property used in a trade or business would apply to property acquired from January 1, 2010 and thereon. The property acquired before that date will continue to be depreciated in accordance with the provisions of the Code before the enactment of Act 171.

Based on the above, it is important to review the additions to property made during 2010 to ascertain that the correct depreciation or amortization is being computed. We may assist you with such computations if you think this may have an impact on your taxable income or deferred tax liability.

Limitation on Mortgage Interest Deduction

Effective for taxable years started after December 31, 2009, individuals may only claim a mortgage interest deduction up to thirty percent (30%) of their adjusted gross income, as defined in the Code, plus any other income excluded from the adjusted gross income. This limitation would not apply to taxpayers that for any of the previous three (3) taxable years claimed mortgage interest deductions that would have been fully allowed considering the new limitation. In addition, the limitation does not apply when the taxpayer or his/her spouse is sixty five (65) years old or more at the end of the taxable year.

Income Tax Exemption of "IVU Lotto"

Any amount or articles received as prizes from the lottery raffles performed as part of the sales and use tax enforcement program known as "IVU Lotto" will be excluded from gross income.

Reduction of Tax Evasion Provisions

Act 171 includes various provisions with the main purpose of reducing the tax evasion. Among these provisions are: the requirement to financial institutions to file an informative return on credit extension transactions of two hundred fifty thousand dollars ($250,000) or more,

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and the requirement to submit evidence of the informative return on commercial transactions in cases of mortgages of five hundred thousand dollars ($500,000) or more.

These informative returns must be filed by the end of the calendar year following the date the transaction took place. There is a penalty of one thousand dollars ($1,000) per informative return for failure to file.

Likewise, it will be a formal requirement in the filing of a financing declaration that evidence of filing of the informative return on commercial transactions be included in cases of liens of two hundred fifty thousand dollars ($250,000) or more.

ACT 172 OF NOVEMBER 15, 2010 ("ACT 172")

Act 172 established a fixed income tax rate of twenty percent (20%) to those taxpayers that participate in the Voluntary Disclosure Program of the Puerto Rico Treasury Department ("Voluntary Disclosure Program"). The taxpayers have the opportunity to declare amounts and pay the twenty percent (20%) income tax on amounts that have been received or earned on or before December 31, 2009 and have not been declared for income tax purposes. Act 172 also provides for the waiver of interest, surcharges, penalties and other additions to the income taxes, as well as a waiver of civil and criminal penalties, if the amounts are declared on or before April 15, 2011.

Finally, Act 172 also applies to municipal license taxes. Taxpayers may declare unreported volume of business for taxable years started on July 1, 2003 and ended on or before December 31, 2009 to the corresponding municipalities on or before June 30, 2011. These taxpayers would also have the relief of paying without interest, surcharges, penalties and other additions to the tax and would not be subject to civil and criminal penalties.

There are various conditions and exceptions to be able to enjoy the benefits of the Voluntary Disclosure Program. Therefore, please contact us should you understand that a particular situation may apply for submission under this program in time to reach April 15, 2011 deadline mentioned above.

ADDITIONAL COMMENTS CONCERNING YOUR 2010 INCOME TAX RETURN AND THE NEW TAX CODE APPROVED ON JANUARY 31, 2011 (ACT NO. 1 OF 2011)

Please note that, in general terms, even though the new tax code will apply for taxable years started after December 31, 2010, the new provisions may have an impact on your 2011 estimated income tax payments. Furthermore, since you may make an irrevocable election so that the Code provisions apply to you for 2011 and four (4) more years, please contact us should you want us to perform the necessary analysis as to determine which election would best suit your business.