

Act 171 – The First Step for a New Tax Reform

On November 15, 2010, the Governor of Puerto Rico approved Act 171 (the “Act”) which constitutes the first step for a New Tax Reform in Puerto Rico. The Act provides amendments to the individual and corporate income tax provisions of the Puerto Rico Internal Revenue Code of 1994, as amended (the “Code”). The amendments to the individual and corporate tax provisions are effective for this filing season. It also introduces amendments to other provisions of the Code and to other special laws in order to enhance enforcement and compliance. We will discuss in general the highlights of those amendments.

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Amendments to Corporate Income Tax Provisions

The Act provides a tax credit for taxable years commencing after December 31, 2009 and before January 1, 2011 to corporations and partnerships that pays the Christmas Bonus required by law. The tax credit is 7% of the net income tax liability, after certain credits. It cannot be applied against the alternative minimum tax or against any preferential tax rate like capital gains tax for example. This credit does not apply to the income tax imposed under the Industrial Tax Incentives Acts. The carryover period of net operating losses is increased from seven (7) years to ten (10) years for net operating losses incurred in taxable years commenced after December 31, 2004 and before December 31, 2012.

It also requires all taxpayers using the straight line method of depreciation to depreciate the additions of fixed assets using the recovery and acquisitions periods used for accelerated depreciation. This may result in a different tax depreciation than that in the accounting books.

Amendments to Individual Income Tax Provisions

The Act provides a tax credit for taxable years commencing after December 31, 2009 and before January 1, 2011 to individual taxpayers depending on their adjusted gross income as follows:

Adjusted Gross Income	% of Credit Based on Net Tax Liability (after certain credits)
\$0 - \$40,000	15
\$40,001 - \$100,000*	10
In excess of \$100,000*	7

*\$150,000 for married taxpayers filing jointly.

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This credit cannot be applied against the alternative minimum tax or against any preferential tax rate like capital gains or dividends. In addition, it cannot result in a refund.

The Act also provides that for taxable years commencing after December 31, 2009 the deduction for interest on residential mortgages is limited to 30% of taxpayer modified adjusted gross income. For purposes of this limitation, taxpayer gross income is adjusted for any item of excludable income like social security or exempt interest for example.

Provisions to Enhance Enforcement and Compliance

The Act also includes certain amendments to the Sales and Use Tax provisions (the "SUT" or "IVU") to enhance enforcement and compliance. Among those amendments are the following:

- The requirement to file SUT returns electronically will now apply to taxpayers with annual sales of \$200,000 or more instead of \$500,000 or more.

- The requirement for electronic deposit of the SUT will now apply to merchants whose deposits for the taxable year exceeded \$12,000 instead of \$30,000.
- Certain amendments to ease the implementation of a sales and use tax lottery ("IVU Loto") as this lottery will provide the mechanisms to gather income or sales data through the point of sale.
- A penalty of up to \$20,000 is imposed if the merchant does not allow for the installation of the IVU Loto terminal.
- IVU Loto prizes are excludable from gross income.
- A new penalty of the higher of \$100 or 10% of the tax obligation is imposed for the failure of not filing the monthly SUT return.

The voluntary failure to withhold or deposit taxes required to be withheld is typified as a third degree felony for which officers of the corporation may be liable.

Financial Businesses including securities brokers will be required to file a new information return whenever credit is extended for more than \$250,000 and \$500,000 if the credit is extended for the acquisition of residential property.

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