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BE AWARE (OR BEWARE) OF THE IMPACT OF THE NEW PUERTO RICO ALTERNATIVE MINIMUM TAX PROVISIONS

By Juan Zaragoza

The Special Act declaring a state of fiscal emergency and establishing an integrated fiscal stabilization plan to save Puerto Rico's credit, signed by the Honorable Governor of Puerto Rico on March 9, 2009 ("the "Act") amended the corporate alternative minimum tax ("AMT") provisions of the 1994 Puerto Rico Internal Revenue Code, as amended. Even though the AMT paid doesn't increase the corporation's income tax provision for the year since it is considered a deferred tax asset for book purposes, in today's cash driven economy making a substantial cash payment to Treasury can have a significant impact in any business.

For taxable years beginning after December 31, 2008 and before January 1, 2012, corporate and partnership taxpayers will be required to add to their alternative minimum net income the deductions related to expenses accrued or paid for services rendered outside Puerto Rico, which were not subject to income tax withholding. The most common of this type of expenses is the home office or intercompany allocation related to support services rendered to the local entity. The other type is services such as legal rendered by an unrelated nonresident party for the benefit of the local entity. In both cases, since the services were rendered outside Puerto Rico they are considered foreign source income and accordingly the local entity (even though it is allowed to claim a deduction) is not required to withhold any income taxes on such payments.

The AMT is imposed at a flat rate of 22% calculated on the alternative minimum net income ("AMNI"). The AMNI is a separate computation which uses as starting point the taxable income subject to normal tax already computed for regular tax purposes. Such taxable income is adjusted to reverse the timing benefit of certain provisions which allow taxpayers to either defer income or accelerate deductions. In addition it is subject to a catch all adjustment which adds back 50% of the excess of the corporation's book income over its AMNI. The corporation is required to pay AMT only if it exceeds the regular tax. Any AMT paid is creditable against regular taxes in future years.

We expect these amendments to have a significant effect on retailers, wholesalers and service entities since those industries have traditionally relied on their parent or affiliate companies to provide their back office support.

We recommend taking a closer look to the home office charges in order to determine their true nature and character. This could have an impact on whether or not they will be subject to the AMT add back adjustment.