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House Bill 3070: Limitations on the Deductibility of Expenses Related to the Use of Automobiles in Businesses

Author

Juan Alvarado
Partner

787-620-7730
jalvarado@zatax.com

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As published in our November Monthly Bulletin of The Tax Advisor, House Bill 3070 (Senate Bill 1909), "which proposes to establish the Puerto Rico Internal Revenue Code of 2010" was filed on November 22, 2010. If approved, it will provide tax reductions to individuals and corporations and will have the main purpose of stimulating the economy and creating jobs. Among the provisions that should be carefully examined are the ones related to the limitations on the deductibility of expenses related to the use of automobiles in businesses.

In the case of automobiles, as such term is defined below, no depreciation expense would be allowed as a deduction. Instead, a deduction for the use of automobiles would be computed based on a standard rate for mileage. The Secretary of the Treasury will determine in the Regulations the standard mileage rate applicable to each taxable year.

For purposes of the limitations, House Bill 3070 defines the term "automobile" 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, <u>except</u> for:

1. Automobiles used directly in the businesses of transporting passengers or property for compensation or payment such as limousines, taxis or public vehicles.
2. Hearses, wreath carriages, omnibuses, ambulances, motorcycles, trucks, vans and any other similar vehicle used principally in the transportation of cargo.
3. Automobiles leased or possessed for leasing to persons regularly devoted to automobile leasing.

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In the case of financing leases of automobiles that meet the definition included on House Bill 3070, the deduction for depreciation would not be allowed. The deduction would also be based on the standard mileage rate.

On the other hand, and in the case of operating leases of automobiles, the amount of the rent would not be allowed as a deduction for depreciation or as a business expenses. The standard mileage rate would replace the rent expense.

No deduction for the expenses related to the use and maintenance of an automobile would be allowed. This includes expenses such as repairs, maintenance, gas, and related expenses. All these expenses would also be replaced by the deduction based on the standard mileage rate.

When an automobile is disposed of, no loss would be allowed as a deduction. In addition, the proposed legislation is silent as to what adjustments would be made to the basis of the automobiles, if any. In the absence of a depreciation expense, will the deduction of the standard mileage rate be a reduction in the basis of the automobiles? Although the adjustment in basis is not relevant if the transaction would result in a loss, it is important in order to determine if there is a gain (which would be taxable) in the transaction.

As you can see, if the proposed legislation is approved, the businesses should evaluate their current arrangements for disbursing the different types of automobile expenses to certain employees. If this evaluation is not made, businesses may end up paying substantial expenses related to automobiles which would not be deductible for income tax purposes. In addition, businesses should review their record keeping procedures in order to properly identify all these auto related expenses that will become nondeductible for income tax purposes.

Key Contacts at Zaragoza & Alvarado LLP:

Juan Zaragoza, CPA
Managing Partner
787-620-7740
jzaragoza@zatax.com

Juan Alvarado, Esq., CPA
Partner
787-620-7730
jalvarado@zatax.com

Felipe Mariani, CPA
Partner
787-620-7736
fmariani@zatax.com

Sandra Marie Torres, CPA
Partner
787-620-7728
storres@zatax.com

Edgardo Sanabria, CPA
Partner
787-999-3015
esanabria@zatax.com

Carlos González, CPA
Partner
787-620-7729
cgonzalez@zatax.com

104 Acuarela Marginal St.
Martínez Nadal Expressway
Guaynabo PR 00969

PO Box 195598
San Juan PR 00919-5598

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