

Travel Expense

Name

E-mail

Purpose

Trip

Deductibility of Payments to Related Persons: What's New?

By Rosirma García-Rivera

As discussed in previous newsletters, Act No. 40-2013, better known as the Act for the Redistribution and Adjustment of the Tax Burden (hereinafter referred to as "Act 40") and Act 163-2013, better known as the Effective Tax Oversight Mechanisms Act (hereinafter referred to as "Act 163") brought significant amendments to the Puerto Rico Internal Revenue Code of 2011, as amended (hereinafter referred to as the "Code"). Some of these amendments intend to limit the deductibility of charges and expenses allocated to the Puerto Rico subsidiaries and to the Puerto Rico branches (hereinafter referred to as "intercompany charges") by related persons not engaged in trade or business in Puerto Rico, or by Home Office.

Act 40 disallows a portion of the intercompany charges to the extent those charges are not subject to Puerto Rico income tax or tax withholding at source. Effective for taxable years commencing after December 31, 2012, fifty one percent (51%) of the expenses incurred or paid to related persons not engaged in a trade or business in Puerto Rico or to Home Office, will be disallowed for purposes of determining the net taxable income of the

Zaragoza & Alvarado LLP

Zaragoza & Alvarado LLP is a Limited Liability Partnership organized under the laws of Puerto Rico and is engaged in providing tax and business advisory services. We are the first truly multidisciplinary tax and business advisory professional service firm in Puerto Rico, unencumbered by the constraints of association with an auditing firm, and the regulatory and disclosure rules of the Security and Exchange Commission.

Backed up by years of unmatched hands-on experience in public accounting, government and corporate tax, our team of tax consultants is redefining the market by providing professional tax and business advisory services through our "top-heavy" structure, designed specifically to provide high level tax consulting to our clients on a more personalized basis.

For information visit us at: www.zatax.com or contact one of our Tax Professionals for an appointment:

Ph. (787) 999-4400
E. taxadvisors@zatax.com

Zaragoza & Alvarado is part of Taxand, the World's largest independent tax consulting organization.



Continues on Page 2

Deductibility of Payments... Continued from Page 1

corporation.¹ If the intercompany charges are subject to Puerto Rico income tax or tax withholding at source, such disallowance will not be applicable.

The 51% disallowance of intercompany charges will not be applicable neither to corporations covered under an industrial or tourism tax exemption grant, but only with respect to the operation covered by the tax exemption grant.

In addition, the intercompany charges that are not subject to Puerto Rico income tax or tax withholding at source will be subject to a twenty percent (20%) alternative minimum tax. This 20% tax will be a component of the second alternative minimum tax computation, together with the alternative minimum tax on purchases from related entities and the additional tax on gross income.

On the other hand, Act 163 incorporated, among other things, new rules for the deductibility of certain expenses paid to nonresident related persons that are subject to the Puerto Rico income tax withholding at source (such as rents, interest, royalties, or any other fixed or determinable amounts). This amendment pretends to match the timing of the deduction of fixed and determinable amounts subject to Puerto Rico tax withholdings to the timing of the payment. In other words, it requires taxpayers to use the cash basis method of accounting with respect to such deductions, so that the timing of the deduction coincides with the payment of the expense. Therefore, the taxpayer will not be able to deduct the charges subject to tax withholding made by a related person until it pays the amount due to such related persons (in which moment the Puerto Rico tax withholding is required by the Code). Since Act 163 was signed on December 25, 2013, this amendment will be applicable for accrued expenses not paid beginning on December 26, 2013 and thereafter.

Z&A's COMMENTS:

The limitations provided by Act 40 and Act 163 are not applicable at the same time. If the intercompany charges are not subject to Puerto Rico income tax or tax withholding at source, then the amendment of Act 40 is applicable (51% disallowance for determining the net taxable income and 20% alternative

minimum tax). However, if the intercompany charges are subject to tax withholding at source, then the amendment of Act 163 is applicable (deduction is allowed only to the extent the payment is made and the Puerto Rico income tax withholding is remitted to Treasury). We encourage you to make a careful evaluation to determine the type of intercompany charges that your entity has, and the applicable rules in order to compute the tax impact. Our representatives are ready to assist you in determining the impact of these new rules to your business.

ABOUT THE AUTHOR

Rosirma García-Rivera



Tax Is Our Business®

Rosirma is a Manager at Zaragoza & Alvarado LLP. She has over ten years of experience in the corporate and individual tax advisory area. Prior to joining the Firm in 2004, Rosirma was a tax associate in the Corporate Tax Department of an international accounting firm in San Juan. She also worked for three years with a local accounting firm. Rosirma specializes in filing tax incentives grants in the construction, energy and tourism industries. She works with computer hardware manufacturers and distributors, food distributors, restaurant chains and entertainment enterprises providing tax consulting and compliance issues.

She has participated as speaker in several seminars sponsored by the Puerto Rico Certified Public Accountants Society in topics related to property, personal and corporate income taxes. She is a member of the Puerto Rico Certified Public Accountants Society and the American Institute of Certified Public Accountants.

Rosirma has a Bachelor in Business Administration degree, major in Accounting, from the University of Puerto Rico.

¹ For purposes of the expenses subject to the disallowance, a related person will include the following: 1) Parent-Subsidiary as long as the shareholder owns 50% or more of the shares of stock in the subsidiary; 2) Brother-Sister as long as shareholders with common interests in both corporations own 50% or more of the shares of stock in both entities; and 3) Home Office-Branch.



Zaragoza & Alvarado LLP Tax and Business Advisory Services

104 Acuarela Marginal Street
Martinez Nadal Expressway
Guaynabo PR 00969

PO Box 195598
San Juan PR 00919-5598

T. 787.999.4400

F. 787.999.4646

E. taxadvisors@zatax.com

www.zatax.com www.taxand.com

We are Green. Are You?



Please consider the environment before printing this publication.

Key Contacts at Zaragoza & Alvarado

Juan Zaragoza-Gómez, CPA

Managing Partner

787-620-7740

jjzaragoza@zatax.com

Juan Alvarado-Zayas, Esq., CPA

Partner

787-620-7730

jalvarado@zatax.com

Felipe Mariani-Franco, CPA

Partner

787-620-7736

fmariani@zatax.com

Sandra Marie Torres-Martínez, CPA

Partner

787-620-7728

storres@zatax.com

Edgardo Sanabria-Valentín, CPA

Partner

787-999-3015

esanabria@zatax.com

Carlos R. González-Martínez, CPA

Partner

787-620-7739

cgonzalez@zatax.com

César De Jesús-Umpierre, CPA

Partner

787-620-7734

cdejesus@zatax.com

This publication supports Zaragoza & Alvarado's marketing of professional services. It is intended for information purposes only and should not be regarded as written advice or recommendation to undertake any position, tax related or otherwise. Readers should not consider the information contained in this publication to be complete, nor act solely on the basis of the material contained herein. Moreover, due to changing laws and associated authoritative literature, that information may not continue to apply to a reader's situation. Therefore, we encourage the readers to contact us or another qualified professional advisor to thoroughly evaluate their specific facts and circumstances; to determine if any information contained in this publication remains valid and; to discuss the potential application of such information to their particular situations.

As provided in Department of Treasury Circular 230, this publication is not intended or written by Zaragoza & Alvarado LLP, to be used, and cannot be used, by a reader or any other person or entity for purposes of avoiding tax penalties that may be imposed on any taxpayer under the Internal Revenue Code.