



Effective Tax Oversight Mechanisms Act: CPA's, the New Tax Oversight Agents

By Corali del Llano-Torres

On December 25th, 2013, the controversial House Bill 1524 was signed into Act No. 163-2013, known as the Effective Tax Oversight Mechanisms Act ("Act 163"). The main purpose of Act 163 is to facilitate oversight by providing fiscal authorities additional tools to maximize collection of taxes. The mechanism: CPAs and supplementary information. To achieve this goal, amendments to the Municipal License Tax Act, Municipal Property Tax Act, General Corporations Act and the Puerto Rico Internal Revenue Code of 2011 (the "Code") were enacted.

The new provisions were effective immediately upon approval of Act 163, except for the supplementary information required by Section 1061.15 of the Code, which is effective for taxable years commenced after December 31st, 2012. However, the Puerto Rico Treasury Department ("Treasury") issued Administrative Determination 13-22 postponing various items of the supplementary information, which will be effective for taxable years commenced after March 31st, 2013.

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In this issue, we will discuss the following changes introduced by Act 163:

- supplementary information to be included with the audited financial statements and the new role of CPAs; and
- new exclusion from gross income.

SUPPLEMENTARY INFORMATION AND THE NEW ROLE OF CPAs

Among other things, the oversight provisions of Act 163 require taxpayers with volume of business of \$3,000,000 or more to file with their returns supplementary information submitted to the audit procedures applied in the audit of the financial statements made by a certified public accountant with a valid license in Puerto Rico. The supplementary information requirements will vary depending on the type of tax return and the type of taxpayer or business conducted. Herein below, we present some of the information required to be verified as part of the supplementary information requirements:

Supplementary Information Related to the Volume of Business Declaration

- Total gross income.
- Breakdown of items included in other income.
- Retailers and Wholesalers – amount of sales returns.
- Gas Stations – amount of gallons sold
- Exempt Businesses under Tax Exemption Grants or Concessions – detail of income from exempt operations and from fully taxable operations.

Supplementary Information Related to the Personal Property Tax Return

- Cash in bank as of January 1st.
- Bank deposits in transit as of January 1st.
- US GAAP value of the monthly inventories (LIFO not allowed), monthly inventory reserves and monthly inventory adjustments, if any.
- Exempt Businesses under Tax Exemption Grants or Concessions – detail of book value of assets not used in the exempt operations as of January 1st.

Supplementary Information Related to the Income Tax Return

- Verification that the withholdings and deposits on the payments of wages and services rendered were made according to the Code.
- Verification that the use tax was reported and deposited according to the Code, and that the sales tax reported and its respective deposits were made, reduced by any credit for sales taxes paid on the purchase of personal tangible property acquired for resale according to the Code.
- Reporting of the ending balance of loans to partners, members, shareholders, or to members of the controlled group or group of related entities.
- Verifications that the Exempt Businesses under Tax Exemption Grants or Concessions comply with the requirements provided for the exemption (effective for taxable years commenced after March 31st, 2013).

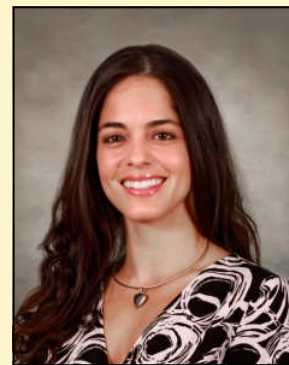
The New Role of CPAs

In addition to the supplementary information, Act 163 imposes several duties and requirements to the CPAs that issue an opinion in connection with the supplementary information. Among them, the CPA is required to retain, for 4 years, all documents supporting the opinion on the supplementary information, respond to any information requirement from the Secretary of Treasury and electronically file the supplementary information required by Section 1061.15 of the Code. Furthermore, Act 163 imposes severe administrative and criminal penalties, and authorizes the Secretary of Treasury to revoke or suspend the CPAs privilege to issue an opinion to address the requirements of this law. These new requirements impose great responsibility to CPAs not only during the audit process of the financial statements, but also afterwards. Fiscal authorities are counting on CPAs and supplementary information as additional oversight tools.

Other oversight measures incorporated by Act 163 include the authorization to the Secretary of Treasury to contract personnel trained in tax matters to examine taxpayer records and to provide technical support to Treasury employees and the acquisition of computer equipment

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Coralí is a Manager at Zaragoza & Alvarado LLP, and has over seven years of experience in the corporate and individual tax advisory areas. Before joining Z&A, Coralí worked as a law clerk for a local law firm specialized in corporate taxes.

Coralí specializes in manufacture, construction and retail. She has experience working with complex tax issues related to tax audits, accounting for income taxes and closing agreements with the Puerto Rico Department of Treasury. She has worked with state and municipal tax exemption grant decrees, complex tax rulings to address impacting different industries and closing agreements related to municipal volume of business and construction excise taxes.

As speaker, she has participated in various seminars and workshops offered to clients such as the Autonomous Municipality of Caguas and the Puerto Rico Chamber of Commerce Students' Chapter, in areas such as the tax reform, corporate, municipal and individual tax returns, and PYMES.

Coralí has a Juris Doctor degree and a Bachelor in Business Administration degree, major in Accounting, both from the University of Puerto Rico. She is a member of the Puerto Rico Certified Public Accountants Society and has been admitted to practice law in Puerto Rico and the U.S Court of Appeals, First Circuit.

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to mechanize the processing and filing of the supplementary information. Also, the Secretary of Treasury is authorized to publish information regarding delinquent taxpayers and withholding agents.

DISCHARGE OF INDEBTEDNESS: A NEW EXCLUSION

Act 163 introduces two important changes in connection with the discharge of indebtedness; first, it incorporates a new exclusion from gross income and second, it imposes a new information requirement. As a general rule, the discharge of indebtedness results in the recognition of gross income for the debtor, unless one of the specific exclusions provided in section 1031.01(b)(10) of the Code apply. Act 163 provides a new exclusion from gross income in the case of income from the discharge of a mortgage loan, which is product of a reorganization of the loan and guaranteed by the taxpayer's "qualified residence", subject that the mortgage doesn't exceed \$1,000,000.

In addition to the new exclusion, Act 163 imposes an additional requirement to claim a deduction in connection with the discharge of indebtedness. Effective December 25th, 2013, the creditor is required to provide an information return to the debtor who benefitted from the discharge. If the creditor fails to provide the information return on or before February 28th of the calendar year following the date of the discharge of indebtedness, any deduction related to the discharge will be denied. The first informative returns required pursuant to this provision were due on

February 28th, 2014, for transactions that occurred after December 24th, 2013.

Z&A'S COMMENTS:

As indicated by Treasury, the requirement to provide supplementary information is a common practice in several jurisdictions, but novel in Puerto Rico. If your business has a sales volume that exceeds the \$3 million threshold, we encourage you to meet with your external auditor to discuss the extent to which these new requirements of supplementary information will impact your business and the additional cost involved, if any. On March 6th, 2014, Treasury released Administrative Determination No. 14-06 to provide additional guidance with regard to the taxpayers subject to the filing of supplementary information, the content of the reports and the way these shall be submitted to Treasury. Interest groups are meeting with Treasury to try to modify some of the supplementary information requirements provided by Act 163. Further

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communications and publications are also expected from Treasury in the near future regarding the effective date for the informative returns related to the discharges of indebtedness and its applicability to non-financial institutions, among others. For updates or questions regarding Act 163, and to discuss how it may impact your business, please contact one of our consultants.



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