

### *Update on Reporting Reimbursed Expenses to Employees and the Deduction of Automobile Expenses*

On December 18, 2012, the Puerto Rico Treasury Department approved its Regulation 8297 (the "Approved Regulation") related to the deduction for the use and maintenance of motor vehicles provided by Section 1033.07(a)(3)(G) of Act I-2011 (the "Act") and the exemption for the reimbursement of expenses by an employer to its employees provided by Section 1031.02(a)(33) of the same Act. These topics were addressed in our Special Bulletins of The Tax Advisor of December 2010, July 2012 and October 2012. In this bulletin, we will compare the proposed regulation with its approved version and will outline the most notable aspects of the deduction of automobile expenses.

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Most of the provisions included in the proposed regulation remained unchanged in the Approved Regulation. Thus, there were no significant changes made to the substance of both, the rules for the exemption of expenses reimbursed by an employer to its employees and the rules for the deductibility of the use and maintenance expenses of automobiles.

The Approved Regulation did include two new significant items:

1. An exception to qualify an expense reimbursement plan which covers exclusively or mainly managerial or highly compensated employees; and
2. An alternate method to account for the traveled business miles in lieu of the odometer reading.

Article 1031.02(a)(33)-4(h) of the Regulations under the Act provides that an expense reimbursement plan that covers exclusively or mainly highly-compensated employees, managerial employees, and or certain employees that are family members of the employer, or any person that has control over the payments, shall not qualify for the exemption given to the reimbursed expenses provided by Section 1031.02(a)(33) of the Act. The Approved Regulation included an exception to this rule, which states that in cases where there is a limited number of employees, the plan shall qualify for the exemption treatment to the extent that it covers 100% of the employees, regardless if they are highly-compensated or managerial employees. For purposes of determining the 100% coverage, all entities part of a controlled group or part of an affiliated group of services, as defined by Section 1081.01(a)(14) of the Act, shall be considered.

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### **Update on Reporting... Continued from Page 1**

As discussed in our previous bulletins, Section 1033.07(a)(3)(G) of the Act, provides that in lieu of deducting the actual expenses paid or incurred for the use and maintenance of motor vehicles (as defined by Act 1-2011), the taxpayer shall deduct an amount based on a standard mileage rate ("SMR"). In other words, the deduction that will be allowed for income tax purposes will be the number of business miles traveled during the year times the SMR. The Approved Regulation maintained the SMR of sixty cents (\$0.60) per mile and kept the same use and maintenance expense definition. In a nutshell, use and maintenance expenses include:

- gasoline;
- repairs;
- oil and filter change;
- car wash;
- tires;
- insurance;
- annual license rights ("marbete"); and
- other routine maintenance expenses of similar nature.

On the other hand, the following expenses shall not be subject to the SMR limitation since they are excluded from the definition of use and maintenance expenses:

- depreciation;
- parking expenses;
- tolls; and
- leasing expenses.

The Approved Regulation also maintained the requirement of keeping a daily mileage journal to support the deduction related to the SMR. As mentioned before, this daily journal must include the following:

- date;
- destiny;
- purpose;
- odometer reading before and after the trip;
- number of traveled miles; and
- total miles traveled during the year.

Article 1033.07(a)(3)(G)-6 (b)(2) of the Approved Regulations provided an alternative for the odometer reading which consists of including in the daily mileage journal the municipalities visited and using the mileage calculator of the Puerto Rico Highways and Transportation Authority to compute the traveled miles. This calculator can be found in the following web address: [http://www.dtop.gov.pr/carretera/det\\_content.asp?cn\\_id=24](http://www.dtop.gov.pr/carretera/det_content.asp?cn_id=24).

When using this method, the taxpayer must indicate in the daily mileage journal that the traveled miles were determined using this alternate method. The Approved Regulation also provides that a taxpayer may change from one method (i.e. odometer reading) to another (i.e. mileage calculator) during the taxable year but not within the same day.

The provisions of the Approved Regulation are effective 30 days after its filing with the Puerto Rico Department of State. However, the rules related to the deduction for the use and maintenance of automobiles are applicable for expenses incurred **after December 31, 2012**.

### **Z&A Comments**

Taxpayers that expect to claim a deduction for the use and maintenance of automobiles during the taxable year 2013 or subsequent taxable years

should comply with the requirements established by the Approved Regulation (i.e. daily mileage journal) to be granted the deduction. The Approved Regulation is very clear in indicating that for purposes of this deduction, estimates will not be accepted. Also, proper cut off procedures must be implemented with regard to the automobile expenses covered by these new rules.

Interestingly, the Approved Regulation allows the taxpayer to use any of the business mileage calculation methods mentioned above to the extent it does not change the method used during the same day. As such, our suggestion is to use the same method for all employees until additional guidance or clarification becomes available.

If you are considering the cost and benefits of establishing a daily mileage journal, please note that taxpayers that do not keep a daily mileage journal will not be allowed to claim the depreciation deduction for those automobiles in their income tax return, in addition to losing the deduction for use and maintenance. Therefore, the lost deductions for not keeping the daily mileage journal in some cases may be significant.

We can help in implementing a process to comply with these new requirements or designing a mechanism to gather all the required data to report in your tax returns.

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