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## Partial Waiver on the Additional Tax on Gross Income - It is Now or Never

By Felipe Mariani-Franco

As you may have read in our prior bulletins, Act 40-2013 established the Additional Tax on Gross Income as one of the factors in both computations of the Tentative Minimum Tax. It also provided the authority to the Secretary of the Treasury to grant a partial waiver to those taxpayers who can prove that this additional tax will cause an undue economic harm to their businesses. For the Secretary of the Treasury to consider granting the partial waiver, the taxpayer must request it following the procedures provided in Circular Letter 13-05 ("CL 13-05"). CL 13-05 requires taxpayers to submit a detailed explanatory memorandum supporting the request for the partial waiver and a "Report of Agreed Upon Procedures" prepared by a CPA licensed in Puerto Rico, which is also a member of a peer review program, certifying certain financial information. (The Tax Advisor Special Bulletin, July 2013)

Act 117-2013, signed on October 14, 2013, made several changes to the provisions of the Puerto Rico Internal Revenue Code of 2011, as amended (the "Code") regarding the partial waiver on the Additional Tax on Gross Income. We discuss those changes in the following paragraphs:

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### Tax Rate Reduction Limitation

Act 117-2013 grants authority to the Secretary of the Treasury to reduce the tax rate used to compute the Additional Tax on Gross Income to a rate which may never be lower than 0.05%. This is a significant reduction on the limitation established under Act 40-2013, which limited the reduction of the tax to a minimum of 0.2%.

This seems to be an acknowledgment from both the Governor and the Puerto Rico Legislature that the Additional Tax on Gross Income has a severe impact on certain industries thus justifying the granting of a partial waiver lower than the previous limitation of 0.2%. However, nothing in Act 40-2013 or Act 117-2013 requires the Secretary of the Treasury to grant the partial waiver even if the taxpayer may establish the existence of undue economic harm (at least from his perspective).

### Due Date for Filing the Request for Partial Waiver

Act 117-2013 establishes the due date of **November 30, 2013** for the filing of requests of partial waiver for all taxable years commencing during calendar year 2013. This means that calendar and fiscal year taxpayers who want to request the partial waiver for their years beginning during 2013 will have a little more than one month to prepare all the documents required by the Puerto Rico Treasury Department. In our opinion, taxpayers need to start the process right away to be able to meet the due date. (Note: Z&A **does not** perform any attest work, including the preparation of "Agreed Upon Procedures")

For taxable years commenced after December 31, 2013, the request for partial waiver must be submitted at any time within that taxable year. Circular Letter 13-20, issued by the Puerto Rico Treasury Department on October 9, 2013, provides that any request for partial waiver filed after November 30, 2013 will be valid for the taxable year commenced after December 31, 2013.

### Due Date for Response from the Puerto Rico Treasury Department

Act 117-2013 not only established a due date for the filing of the request for partial waiver, but also imposed a due date for the Puerto Rico Treasury Department to respond to such request. The Puerto Rico Treasury Department has up to February 28, 2014 to evaluate and either accept or reject the requests for partial waivers filed on or before November 30, 2013. For those requests filed after November 30, 2013, the Puerto Rico Treasury Department has 90 days after the request has been filed to answer.

The due dates for the response will only apply to those requests for partial waivers that include all the information required by the Regulations or other official documents issued by the Secretary of the Treasury and which are timely filed. The Secretary of the Treasury may request any information he deems necessary to clarify any fact included in the request. Such request of additional information should be made not later than 60 days after the request for partial waiver was filed. The term for the response will be put on hold from the day the Secretary of the Treasury requests the clarifying information until the taxpayer submits the information requested. The term for the response will continue counting the next working day after the receipt of the information.

The requests for partial waiver filed according to the Code, upon which the Puerto Rico Treasury Department has not responded by the term provided under Act 117-2013, will be deemed automatically approved and the tax rate applicable to the taxpayer will be reduced to 0.1% for the applicable taxable year.

### Term of the Partial Waiver

Act 117-2013 provides that all partial waivers approved under the Code will be effective for a period of two taxable years.

### Waiver from the Filing Fees

All requests for partial waivers must be filed together with a filing fee of \$1,500 for them to be processed by the Puerto Rico Treasury Department. However, Act 117-2013 established a waiver from such filing fee to those taxpayers with annual sales lower than \$3,000,000.

### Circular Letter No. 13-20 ("CL 13-20")

## ABOUT THE AUTHOR

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**Felipe** is a Partner at Zaragoza & Alvarado LLP. Before joining the Firm, he worked in several tax and audit positions for local and multinational accounting firms.

Felipe has extensive experience in corporate tax advisory for the oil, manufacturing, distribution and retail industries. Among his areas of expertise, Felipe works with corporate tax incentives, corporate reorganizations, closing agreements with governmental entities and tax accounting work. During 2008, Felipe was a member of the Puerto Rico Treasury Department Team in charge of the drafting of the regulations of the 2008 Act. In 2007, he participated in the preparation of the Sales and Use Tax (SUT) legislation for the Municipality of Dorado. During 2006 he was a member of the team that worked in the preparation of the first Sales Tax Legislation in Puerto Rico, either at the State or Municipal level, for the Autonomous Municipality of Caguas. The engagement included the preparation of the related regulations.

Felipe is member of the Puerto Rico Certified Public Accountants Society and the American Institute of Certified Public Accountants. He has a Master in Professional Accounting degree, major in Taxes, from the University of Texas at Austin and a Bachelor in Business Administration degree, major in Accounting, from the University of Puerto Rico.

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CL 13-20 was issued to establish the procedures and information that the CPA is required to include in the "Report of Agreed Upon Procedures" as part of the request for partial waiver. CL 13-20 also includes two attachments which provide a draft of the "Report of the Agreed Upon Procedures" and draft statements to be made part of such report.

CL 13-20 should be the main tool used by the CPA preparing the "Agreed Upon Procedure" report. CL 13-20 is also extremely helpful for the taxpayer for organizing the information to be provided to the CPA. It includes a detailed explanation of each item to be included in the "Agreed Upon Procedure" and the procedure to be followed by the CPA.

#### Z&A's Comments

The time to decide to request a partial waiver on the Additional Tax on Gross Income has come. Leaving it for later is not an option, is now or never.

Therefore, we recommend taking the following steps sooner rather than later:

#### **Determine:**

Determine the impact of the Additional Tax on Gross Income on your company. Many taxpayers have already computed their income tax for the year considering the changes from Act 40-2013 and Act 117-2013 for purposes of their estimated tax payment of October 25. If you have not gone through the process, we recommend you do it right away.

#### **Decide:**

Decide whether a request for partial waiver is beneficial for your business. The fact that you may be subject to the Additional Tax on Gross Income does not mean that you automatically should request a partial waiver. You need to take into consideration the cost of the process versus the benefit that may be obtained. Remember that the Puerto Rico Treasury Department is not required to grant a partial waiver, so their response may be negative.

Decide who will perform the "Agreed Upon Procedure". Remember that whoever you choose needs to be part of a peer review program (obtain documentation from the CPA certifying that requirement before you proceed). As mentioned above, Z&A does not provide attest services and may not assist you in the "Agreed Upon Procedure".

Decide who is going to prepare the

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memorandum supporting the request for partial waiver. We recommend this to be a team effort between the financial and tax areas of the company. A tax consultant may help you develop the memorandum and serve as a good sounding board. Consider the assistance of an economist to discuss the economic issues of the industry and their margins. This information may provide the background needed to justify the undue economic hardship.

Finally, you should determine if your business is also subject to the Tentative Minimum Tax components related to intercompany purchases and intercompany expense allocations. If that is the case and considering the existence under the Code of waiver provisions for these two components, you should consider the possibility of simultaneously requesting a waiver for the three Tentative Minimum Tax components.

#### Plan:

Establish a plan, together with the CPA, for the completion of the "Agreed Upon Procedure". This plan should include the members of the team and the responsibilities they will have. Setting due dates for each party and status meetings will certainly help. Remember that you need to file the request for partial waiver before November 30, 2013 and there is no extension for such due date.

Establish a plan for the preparation of the memorandum. This plan should include

a summary of the areas to be covered in the memorandum and who will be responsible. If possible set due dates for

the gathering of data and completion of the steps in the plan. Make sure that the memorandum you are planning for is complete and that it covers all relevant areas of the company.

#### Execute:

After determining, deciding and planning all that is left is to execute and complete the task. Make sure that all the information requested by CL 13-20 is included in the "Report of Agreed Upon Procedure".

Also, make sure that the figures used in the memorandum agree with the ones in the "Agreed Upon Procedure".

Remember that the "Agreed Upon Procedure" is where the facts and figures are presented and that the memorandum is where such facts and figures are explained and put into context to support the request of partial waiver.

Make sure that the memorandum presents the facts of the company, that those facts are well explained and that the conclusions reached are logical when analyzed based on the data presented.

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