

House Bill 1645 Seeks to Amend the Puerto Rico Internal Revenue Code of 2011

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Tax Alert

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Governor Pedro Pierluisi recently introduced in the Puerto Rico Legislature an anticipated tax reform project as House Bill 1645 (the “Bill”). The Bill seeks to amend the Puerto Rico Internal Revenue Code of 2011 (the “Code”) by offering tax relief to individuals and corporations, simplifying the tax system, consolidating tax returns and forms, and facilitating doing business in Puerto Rico. The Bill, which also would clarify and correct various provisions of the Code, must now navigate Puerto Rico’s politically divided legislature.

Some of the most important income tax provisions of the Bill applicable to legal entities, as well as provisions related to property taxes, are discussed below. The Bill’s income tax provisions applicable to individuals, Sales and Use Tax and municipal license taxes are discussed in a separate Tax Alert.

Corporations

- **Normal Tax and Additional Tax** - Effective for taxable years beginning after December 31, 2022, the 20% normal tax would be substituted by graduated rates as follows: (i) 17% if net income is no greater than \$275,000, (ii) \$46,750 plus 27% of net income in excess of \$275,000 if net income is in excess of \$275,000 but not greater than \$3,000,000, and (iii) \$782,500 plus 33% of the excess over \$3,000,000 if net income is greater than \$3,000,000. No additional tax would be imposed for taxable years beginning after December 31, 2022. Thus, the highest corporate income tax rate would be reduced from 37.5% to 33%.
- **Alternative Minimum Tax (“AMT”)** - The \$500 minimum tentative tax would be eliminated.
- **Alternative Minimum Net Income (“AMNI”)** - To compute the AMNI, the Bill would eliminate the requirement to file with the income tax return a reconciliation of expenses accrued for accounting purposes and amounts reported in the informative returns as a condition to claim as deduction for certain payments related to the taxpayer’s trade or business. Taxpayers instead would be required to prepare and maintain records of such reconciliations.

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In determining the AMNI subject to the AMT, the taxpayer would exclude the total amount received as dividends from (i) a domestic corporation, (ii) a foreign corporation with at least 80% of gross income effectively connected with Puerto Rico for the last three taxable years, and (iii) income from activities covered by a tax incentives grant, up to the amount of the dividend that has not been included in net income for purposes of computing the regular tax.

Other Legal Entities

- The definition of a Limited Liability Company (“LLC”) would be amended to clarify that for taxable years starting after December 31, 2022, an LLC may elect to be treated as a Disregarded Entity even if it has a sole member who is a non-resident individual.
- Would clarify that any foreign entity that is not considered a corporation, partnership or trust, will be considered and treated as an LLC under the Code.
- The definition of Conduit Entity would be amended to include any entity that has legal personality different from its owners, partners or members.
- Special Partnerships and Corporations of Individuals would not be considered entities for purposes of the definitions of a Group of Related Entities and of Related Persons.
- Would clarify that when there is a change in entity classification that involves a foreign corporation, a ruling request should be requested within 183 days of the date when the election is submitted.
- The provision related to the sale of partnership interests would be amended to correct certain section references related to the amount of gain derived in such sale by a foreign corporation or nonresident alien individual.
- The provision related to the obligation to file income tax returns for partnerships and LLCs would be amended to substitute the term “partnerships” for Conduit Entities and eliminate LLCs.

Engaged in Trade or Business

- The Bill would clarify that a person will not be considered engaged in trade or business in Puerto Rico for income tax purposes if it merely renders services in Puerto Rico at any time during the year. To this end, the activities in Puerto Rico would have to be considerable, continuous and regular,

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considering the nature of the business activities of the person within and without Puerto Rico.

Remote Employees

- The Bill would clarify that a Remote Employee will not be taken into account in determining whether the employer is a merchant for Sales and Use Tax purposes.

Liquidations

- The sworn statement required to be filed with the Secretary of the P.R. Treasury Department (“Secretary”) upon the adoption of a liquidation plan would have to be submitted by any type of entity, not just corporations or partnerships, and the Secretary may require this statement be filed electronically.
- In the case of certain changes in tax treatment that are treated as dissolutions or liquidations, the thirty-day period to file this statement would start to run after filing the application for the change.
- Similarly, the sworn statement regarding distributions in liquidation to be filed on or before February 28 of the following year would be required of any entity, not just corporations or partnerships.

Estimated Tax Payments

- The Bill would codify the provisions in P.R. Internal Revenue Circular Letter 23-03 applicable to estimated tax payments by entities that hold tax incentives grants for manufacturing under Acts 135, 73 or 60 and that elected to be taxed under the provisions of Act 52-2022.

Foreign Financial Accounts

- The requirement that Puerto Rico residents report financial accounts held outside Puerto Rico or the United States would apply to taxpayers holding in the aggregate more than \$10,000 in all financial accounts located outside Puerto Rico or the United States. The Secretary may exempt individuals from this reporting requirement under certain circumstances.

Tax Returns and Reports

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- To consolidate in only one form the quarterly and annual returns filed by employers to report payroll taxes on wages paid to employees, the Secretary of the P.R. Department of Labor would execute a collaboration agreement with the Secretary to submit through SURI the declaration of wages and the payment of taxes currently made through the Employers Services Portal of the Department of Labor. The Collaboration Agreement would be effective on or before January 1, 2024.
- The informative return for transactions made by electronic means (Form 480.6 G) would also be required of payment processing businesses whose online platform offers various payment selection mechanisms on behalf of Participating Merchants. The term Participating Merchant also would cover a merchant that accepts payments through mobile apps and is engaged in any type of commercial activity. This return also would be filed to report payments related to activities within a network or medium.
- For tax years that start after December 31, 2022, the Annual Report and the Compliance Certificate required of persons holding grants of tax exemption, and the applicable filing fee, would be filed electronically with the Secretary together with the income tax return, rather than with the Office of Incentives. The Secretary may postpone the effective date of this requirement.
- If the Secretary issues a pronouncement of general circulation extending the filing dates of the income tax return in case of extraordinary circumstances or emergency declarations, the Executive Director of the CRIM and each municipality would be required to grant the same extension of time to file the personal property and the municipal license tax returns. However, this date cannot be extended by more than 6 months after the due date for filing the income tax return.
- For personal property taxes, the Bill would clarify that the requirement to file audited financial statements with the return applies to taxable years commenced after December 31, 2021.

Administrative Procedures

- **Mathematical Error** - The Bill would eliminate assessments due to a “mathematical error.” The assessment process formerly used to notify a mathematical error only would be used to assess return adjustments. For these purposes, a “return adjustment” also will include (i) a difference between the amount reported in an informative return or withholding statement and the information contained in the income tax return filed by the taxpayer; (ii) a difference between the information reported by the

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taxpayer in its income tax return and the information received by P.R. Treasury from the federal government in a Form 1099 or any other form used by the federal government to report income; and (iii) an adjustment resulting from having more than one taxpayer claiming as a dependent the same individual. The expedited process to challenge a return adjustment would be repealed.

- **Offer in Compromise and Voluntary Disclosure Programs** - In an Offer in Compromise with a taxpayer, the Secretary would be authorized to waive principal, interest, surcharges, and penalties imposed by the Code, and may establish a payment plan shorter or longer than six months. For a Voluntary Disclosure program, the Secretary would be authorized to waive only surcharges and penalties, and may not agree to a payment plan longer than six months. Taxpayers under a Voluntary Disclosure program will not be referred to the P.R. Justice Department for criminal prosecution.

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