

November 3, 2010 www.mcvpr.com**TAX ALERT*****Phase One of Puerto Rico 2010 Tax Reform and Voluntary Declaration Program***

House Bill 3028, filed on October 26, 2010 is the first of several that will be filed to amend the Puerto Rico Internal Revenue Code of 1994, as amended ("Code"), as part of the 2010 Tax Reform. It is designed to provide immediate tax benefits for taxable years commencing on or after January 1, 2010. Its highlights are:

A. New Credits for 2010

1. Corporations and Partnerships

In the case of corporations and partnerships, the bill would amend the Code to establish a 7% income tax credit that would only be available to those entities that pay the Christmas Bonus pursuant to the Puerto Rico Christmas Bonus Act to every eligible employee.

2. Individuals

In the case of individuals, the credit would reduce the income tax as follows, after all other credits allowed are applied:

House Bill 3028: Additional Credits for 2010	
Adjusted Gross Income	Amount of Credit
\$40,000 or less	15%
Between \$40,001 and \$100,000 (\$150,000 if the taxpayers are a married couple filing a joint return)	10%
Over \$100,000 (\$150,000 if the taxpayers are a married couple filing a joint return)	7%

The bill also provides that married couples that live together, file a joint income tax return, and both spouses work, would have the option of selecting that the credit be applied to each of the spouses individually. Note that this credit would not be refundable.

B. Measures to Reduce Tax Evasion

1. New Limit on Mortgage Interest Deduction

The bill would amend the Code to limit the amount of the deduction for mortgage interest paid during a tax year to 30% of the individual taxpayer's adjusted gross income. This change would apply for tax years commencing after December 31, 2009.

2. New Informative Return Required (Credit Transactions)

The bill would amend the Code to require every financial business (as defined in the Code) to file an informative return (the "Informative Return") with the Puerto Rico Treasury Department ("Treasury") for each credit application or extension transaction for an amount of \$250,000 or more (\$500,000 in the case of credit applications related to the acquisition of residential property). The return would include the name of the applicant, the physical and postal addresses, the social security number, account numbers and any other financial information provided to the financial institution handling the application. This mechanism would allow Treasury to reconcile the taxpayer's financial information, as reported in the tax return, with the one provided to financial institutions, and determine if there are any differences leading to unreported income for taxation purposes.

The bill would amend the Puerto Rico Mortgage and Registry of Property Act to require that evidence of filing of the Informative Return with Treasury be submitted before any mortgage of over \$500,000 is registered. Similarly, the bill would amend the Commercial Transactions Act to require that any financing agreement that establishes a lien valued over \$200,000, includes evidence of the filing of the Informative Return with Treasury.

3. Civil and Criminal Penalties Imposed on Corporate Officials

The bill would impose civil and criminal responsibility on the corporate or accounting officers responsible for collecting and accounting for and remitting any tax imposed in the Code.

C. Allowance for Depreciation

The bill would amend the Code to provide that intangible property, other than goodwill, which is either acquired by purchase or developed after September 1, 2010, be depreciated using the straight-line method and using a useful life of 15 years.

Corporations or partnerships, which total income for the tax year does not exceed \$5,000,000, would have the option to deduct the total cost of computer systems and their installation in the year of its acquisition and installation. Equipment previously depreciated by a shareholder or partner of the corporation or partnership or acquired from a related person would not be eligible for the accelerated depreciation.

D. Sales and Use Tax

The bill would amend the Code to lower the annual sales volume threshold for requiring the filing of monthly sales and use tax ("SUT") returns using electronic means from \$500,000 to \$200,000. Similarly, the Secretary of Treasury ("Secretary") would have the authority to require merchants with annual electronic SUT deposits in excess of \$12,000 to remit monthly SUT collected no later than the 10th day of the calendar month following the month of the underlying transactions or at any other time and in any other way, as established through regulations, circular letters or administrative determinations of general application. In addition, the Secretary would have the authority to require the electronic filing of monthly SUT returns in other instances.

A new penalty would be added to the Code for failure to file the monthly SUT return when and in the form required by the Code. Such penalty would consist of the greater of \$100 or 10% of the SUT liability.

The bill would amend the Code to establish that awards and prizes given away pursuant to the soon to be established "SUT Lotto" will be tax-exempt for the recipient.

E. Increase in the Net Operating Loss Carry Forward Period

The bill would amend the Code to increase the allowable net operating loss carry forward period from seven (7) to ten (10) years in connection with losses incurred during tax years commenced after December 31, 2004 and before December 31, 2012.

Voluntary Declaration Program

Also, and as part of the 2010 Tax Reform, House Bill 3029 was filed on October 26, 2010. This bill would establish a Voluntary Declaration Program ("Program") to provide total exemption from the imposition of interest, penalties and surcharges related to the failure to report or the under-reporting of gross income subject to taxation under the Code and of volume of business subject to municipal license taxes under the Municipal License Tax Act of 1974, as amended, for taxable years commencing on July 1, 2003 and ending on December 31, 2009.

Under the Program taxpayers would have to file a special declaration reflecting the income or volume of business and the tax years in which it was received or accumulated. Gross income so declared will be subject to a flat 20% tax rate and the volume of business will be subject to the municipal license tax rate in effect during each tax year for which volume of business is being declared.

A. Eligibility for the Program

In order to participate in the Program taxpayers must comply with the following requirements:

1. File a complete, correct and truthful return or declaration on or before April 15, 2011, for each tax year from July 1, 2003 to December 31, 2009;
2. Pay the totality of the corresponding income taxes or municipal license taxes no later than June 30 2011; and
3. Comply with any other requirement determined by the Secretary of Treasury.

The Program will not be available under the following circumstances:

1. If prior to requesting the benefits the taxpayer:
 - a. received a notice of the commencement of an audit;
 - b. is under an audit;
 - c. received a preliminary or final deficiency notice or a notice of proposed or estimated adjustments as a result of an audit, investigation or other; or
 - d. has a pending matter related to Puerto Rico income taxes or municipal license taxes before any local or federal court.
2. To any matter that is object of an assessment or part of an assessment that has been confirmed by any local or federal court.
3. To any person subject to a criminal investigation or to a criminal or civil lawsuit pending before any local or federal court in connection with nonpayment, delinquency or fraud with respect to any tax imposed by Puerto Rico.
4. Any corporation enjoying tax exemption under the "Economic Incentives for the Development of Puerto Rico Act," Act No. 73 of May 28, 2008, the "Tourism Development Act of 2010", Act No. 74 of July 10, 2010, or any other law of similar nature.

B. Other Highlights of the Program

Participation in the Program entails an express and absolute waiver of all administrative and judicial appeals rights with respect to the tax liability.

No payment under the Program may result in either a refund or a credit.

Once a declaration is approved by the Voluntary Disclosure Unit, it will be final with respect to the information disclosed, except in the case of fraud or malfeasance, in which case the declaration may be annulled and any matter covered by the declaration may be reopened. In such case, penalties, interest and surcharges may apply.

If an eligible taxpayer does not participate in the Program while being eligible to do so in connection with one or more of the periods covered under the Program and does not otherwise satisfy its tax liability, any interest or penalties on such liability will be 200% of the amount that would otherwise be imposed.

Taxpayers that participate in the Program will not be subject to civil or criminal penalties imposed by any tax laws or the provisions of the Puerto Rico Penal Code related to tax laws violations. The scope of this immunity will be limited to the specific declarations filed with respect to the tax years for which the declarations were submitted.

For updates on this matter, you may contact any of the attorneys listed below, all members of our [Tax Practice Group](#).

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