

TAX ALERT

July 10, 2008

Incentives for the Development of Puerto Rico Small Businesses Act

House Bill 5351 ("H.B. 5351"), the Incentives for the Development of Puerto Rico Small Businesses Act ("IDSBA") was recently approved by the Puerto Rico Legislature, and is expected to be enacted into law by the Governor of Puerto Rico in the coming days. It is designed to stimulate the growth of Puerto Rico's economy by implementing a special tax regime and providing other incentives to energize the small and medium business sector ("PYMES" for its Spanish acronym).

In general, the IDSBA reduces tax and economic burdens imposed on PYMES whose annual gross income does not exceed \$5MM. Benefits include those relating to self-employed individuals ("D/B/As") whose annual gross income is \$1MM or less, and PYMES corporations having gross income of up to \$5MM. The following are the major highlights of the IDSBA:

I. Income Taxes

- Corporations and partnerships with gross income of no more than \$5MM may enjoy a reduced flat income tax rate of 30% (25%, if annual average employment is seven or more persons). These businesses will no longer be subject to graduated surtax rates.
- Corporations and partnerships with gross income of no more than \$5MM are allowed to claim a current deduction for the total cost of computers used in the business, in the year in which acquired and installed. This accelerated depreciation does not apply to equipment previously depreciated by a related person. In addition, these entities may elect to depreciate motor vehicles for land use (excluding automobiles) and environmental conservation equipment over a two-year period using the straight-line method.
- Every individual engaged in a trade or business deduct from its gross income 50% of the self-employment tax paid to the U.S. Internal Revenue Service.
- Self-employed individuals with a trade or business whose gross income does not exceed \$500,000, may deduct health insurance premiums paid for themselves and their families as an ordinary and necessary business expense, to the extent all other employees are also covered.

II. Reporting Obligations

- The volume of business threshold to trigger the requirement that audited financial statements be included with a corporation's or partnership's Puerto Rico income tax and personal property tax returns or volume of business declarations, and with a domestic corporation's corporate annual report to the Department of State, is increased to \$3MM.

III. Compensation for Work-Related Accidents

- The Compensation System for Work-Related Accidents Act of 1935, as amended (“Fondo”), is now applicable to owners who work full-time in a trade or businesses with an annual gross income of \$1MM or less.

IV. Effective Date

- Most of the IDSBA provisions will be effective when H.B. 5351 is signed by the Governor. However, provisions related to tax rates and certain deductible business expenses would be effective for taxable years commenced after December 31, 2008.

* * *

If you have any questions or comments, or wish additional information regarding the matters discussed herein, please contact any of the attorneys listed below, all members of our Tax Practice Group:

Juan L. Alonso	787-250-5655	jla@mcvpr.com
Roberto L. Cabañas	787-250-2611	rlc@mcvpr.com
Carlos E. Serrano	787-250-5698	ces@mcvpr.com
Xenia Vélez	787-250-2620	xv@mcvpr.com

This Tax Alert has been prepared by us for information purposes only. It is not intended as, and does not constitute, either legal advice or solicitation of any prospective client. An attorney-client relationship with McConnell Valdés LLC cannot be formed by reading or responding to this Tax Alert. Such a relationship may be formed only by express agreement with McConnell Valdés LLC.