

Technical Amendments: Partnerships, Special Partnerships, Corporations of Individuals and REITs

ATTORNEYS

- Isis Carballo-Irigoyen
- Yamary I. González-Berríos
- Rubén Muñiz-Bonilla
- Rafael Fernández-Suárez
- Lillian Toro-Mojica
- Mariana M. Contreras-Gómez
- Leyla González-Ibarría
- Xenia Vélez
- Carlos J. Villafañe-Real
- Carlos E. Díaz-Wert
- Natalia C. Rodríguez-Alegría
- Dalina Sumner
- Esteban R. (Ricky) Bengoa

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Following is a summary of the technical amendments approved by the recently enacted Act 40-2020 (“Act 40”) which incorporates technical amendments to the Puerto Rico Internal Revenue Code of 2011, as amended (“PR Code”).

This summary specifically addresses Partnerships, Special Partnerships, Corporations of Individuals and Real Estate Investment Trusts (“REIT”). **Unless otherwise stated, the amendments become effective on April 17, 2020, date of the approval of Act 40.**

Limited Liability Companies (“LLC”)

In the case of a conversion of a corporation into an LLC electing to be treated as a partnership, the election will be effective as of the first day of the taxable year in which the conversion was effective.

Reorganizations of Pass-through Entities

The liquidation of a special partnership or corporation of individuals with a subsequent contribution of all assets and liabilities to a new or pre-existing partnership will be treated as an exempt exchange of assets and liabilities of the special partnership or corporation of individuals in exchange for a participation in the partnership.

Partners and Shareholder Share in Income and Expense Items of Partnerships, Special Partnerships and Corporations of Individuals

A partner will not have to consider separately the partnership’s or special partnership’s income, expenses and deductions for purposes of determining the partner’s alternative minimum tax if the partnership or special partnership submits with its tax return audited financial statements and the required Supplementary Information, or submits the Agreed Upon Procedures report or Compliance Attestation prepared by a CPA.

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Similarly, a shareholder in a corporation of individuals will not have to separately consider the net income of the corporation of individuals determined pursuant to PR Code Section 1021.02(a)(2), if the corporation of individuals submits with its income tax return audited financial statements, along with the supplemental information required in PR Code Section 1061.15 (b), or an Agreed Upon Procedures report or Compliance Attestation performed by a CPA.

Effective for taxable years beginning after December 31, 2019, partnerships, special partnerships and corporations of individuals whose volume of business is less than \$1,000,000 may comply with the above requirement by electing to submit with the tax return a due diligence checklist to be provided by PR Treasury, duly sworn by a Tax Return Specialist Agent, instead of the Agreed Upon Procedures report or Compliance Attestation prepared by a CPA.

Real Estate Investment Trusts (REITs)

- Qualification: To determine if a REIT's equity is owned by not less than 20 persons, a look-through rule is established for equity owned through a foreign entity if:
 - Under the US Internal Revenue Code or its regulations, or analogous provisions of foreign law, the entity is treated as a corporation for income tax purposes;
 - The entity is not subject to income tax in the country where organized or created; and
 - The entity is not engaged in a trade or business, other than the acquisition, ownership and sale of investments and the collection and distribution of income, profits and gains therefrom to its equity-holders.

The above look-through rule also applies to determine whether five individuals or less own more than 50% of the equity in the REIT.

- Taxation: For entities that meet the above criteria, the tax on dividends distributed by the REIT will be imposed at the equity-holder, rather than entity level.

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