

Technical Amendments Act: Corporations and Non-for-Profit Entities

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An McV Tax Alert

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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 Corporations and entities exempt from income taxes pursuant to PR Code Section 1101.01 (“Non-for-Profit Entities”).

Unless otherwise stated, the amendments become effective on April 17, 2020, date of the approval of Act 40.

Deductions Allowed to Determine Alternative Minimum Net Income

Act 40 made the following changes to the PR Code regarding the computation of net income for alternative minimum tax purposes:

- A corporation may claim a deduction for payments made for insurance premiums, advertising, telecommunication, internet and cable or satellite television services, if: (i) said payments are directly related to the operation of the trade or business; and (ii) the amounts paid were adequately reported in an informative return.
- Payments made for water and electric power services directly related to the operation of a business do not have to be reported in an informative return to be deductible.
- In computing the alternative minimum net income, a corporation can claim the deductions available in determining the net income subject to normal tax only if it submits with its income tax returns audited financial statements with the required Supplementary Report or submits the Agreed Upon Procedures Report or Compliance Attestation, regardless of the volume of business of the corporation.

Optional Tax for Corporations Engaged in Rendering Services

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Act 40 clarifies that corporations engaged in rendering services can elect to pay the optional tax on gross income, instead of paying a tax on net income, if:

- At least 80% of the corporation's gross income for the taxable year for which the election is made is derived from the rendering of services; and
- Either the entire gross income of the corporation was subject to withholding, or the estimated tax requirement for the taxable year was fully met.

Net Operating Losses (“NOLs”)

Act 40 clarifies that the amount of the NOLs deduction will be determined **before** taking into consideration the dividend received deduction.

Insurance Company Income Tax Return

For taxable years beginning after December 31, 2018, all insurance companies must file their income tax returns on or before the 15th day of the **6th month** following the close of the taxable year. An automatic extension for a period of 3 months will be granted if timely requested. For taxable years beginning after December 31, 2016, the automatic extension is for a period of 6 months from the filing due date.

Informative Return for Non-for-Profit Entities

For taxable years beginning after December 31, 2018, Non-for-Profit Entities must file their income tax returns on or before the 15th day of the **6th month** following the close of the taxable year.

Secondary Entities as Non-for-Profit Entities

The PR Code was amended to include “secondary entities” as Non-for-Profit Entities. A secondary entity is any entity that meets the following requirements:

- The entity must be either: (i) a subsidiary of or a related person with respect to one or more organizations that are tax-exempt under PR Code Sections 1101.01(a)(1) or (2) (“Primary Entities”), or (ii) under the control and close supervision of Primary Entities;
- The entity is engaged solely in activities that are an integral part of the Primary Entities, including management and administrative services and investment management, among others; and

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- The activities carried out by the entity could have been carried out by the Primary Entities without them failing to comply with the requirements established in PR Code Section 1101.01.

Puerto Rico Income Tax Exemption Request for 501(c)(3) Organizations

Entities enjoying tax exemption under the provisions of Section 501(c)(3) of the U.S. Internal Revenue Code can be granted exemption, at the discretion of the Secretary of the PR Treasury, under PR Code Section 1101.01(a). The exemption can be granted even if the activity carried out by the entity is not specifically identified as an eligible activity under PR Code Section 1101.01 if the Secretary determines that granting the exemption will be in the Puerto Rico's best interests.

Unrelated business net income of Non-for-Profit Entities

For taxable years beginning December 31, 2018, unrelated business net income of Non-for-Profit Entities will be subject to an 18.5% normal tax rate (instead of 20%).

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