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TAX ALERT
July 15, 2009

AMENDMENTS TO ACT NO. 7 OF MARCH 9, 2009, KNOWN AS THE "OMNIBUS PLAN FOR ECONOMIC RECONSTRUCTION ACT"

On July 10, 2009, Governor Luis Fortuño signed H.B. 1640 into law as Act No. 37 of July 10 2009, ("Act No. 37"), which substantially amends Act 7 of March 9, 2009 ("Act 7"). Below is a list of the major changes introduced by Act No. 37:

1. Tax Credit Moratorium

As introduced by Act 7, the moratorium affected the following eight types of tax credits:

a. Credit for purchase of articles manufactured in Puerto Rico for local sale and consumption;

b. Solid waste credits;

c. Venture capital credits;

d. Urban centers revitalization credits;

e. Theater district credits;

f. Conservation credits;

g. Social interest housing credits; and

h. Housing infrastructure credits.

Act No. 37 modified these provisions as follows:

- Limitation on Use

  - All credits listed above, issued before **March 9, 2009** shall be subject to the moratorium. Originally this date was January 1, 2009.

  - As an exception to the generally applicable use moratorium, credits either: (i) acquired by purchase; or (ii) granted as a result of a closing agreement with the Secretary of the Treasury ("Secretary") before March 4, 2009, shall not be subject to the credit moratorium.

- Credits granted under Act No. 212 of August 29, 2002, subject to the moratorium now clearly include both, the originally limited credit for Infrastructure Investments and the Credit for Investments in Construction Projects in Urban Centers. Further, Act No. 37 introduces the following limitations to the use of the credit:

Year credit was granted	Maximum amount per year of credit	Credit may be used in:
Fiscal year 2009-10	50%	Taxable years commencing after December 31, 2009 and before January 1, 2011.
	50%	Taxable years commencing after December 31, 2010 and before January 1, 2012.
	Any excess may be carried over to future taxable years.	
Fiscal year 2010-11	50%	Taxable years commencing after December 31, 2010 and before January 1, 2012.
	50%	Taxable years commencing after December 31, 2011 and before January 1, 2013.
	Any excess may be carried over to future taxable years.	

- <u>Limitation on Grants</u>

  - Article 30 of Act 7 provided a three-year moratorium on the granting of additional tax credits, commencing during the calendar years 2009, 2010 and 2011.

  - Under Act No. 37, the moratorium period will end in 2011 or when a total of $690 million is collected, whichever occurs first. Moreover, the credits subject to the moratorium may be granted if the eligibility requirements were submitted to the Puerto Rico Treasury Department ("Treasury") <u>before</u> the effective date of Act No. 37. To that end, in the case of Act 212 credits, the municipalities may evaluate and issue certificates of compliance for projects with certificates of eligibility submitted to Treasury. In all cases, grants of tax credits shall be <u>limited</u> to $40 million for each year the moratorium is in effect, provided no credit exceeding $15 million is granted to any one project. Act No. 37 does not specify how the $40 million will be allocated among applicants.

- Credits will not be subject to the moratorium if the application for the tax credits was submitted to the entity responsible for granting the credit before March 9, 2009, and had complied with all requirements provided by the applicable laws, regulations and administrative determinations by that date.

- Tax Credit Registry

  - Act 7 introduced the Registry of Tax Credits to keep a record of all tax credits to be claimed after the expiration of the moratorium. Taxpayers were required to file an informative return with the Secretary on or before May 30, 2009, in order to inform any pending credits to be claimed after the expiration of the moratorium.

  - Act No. 37 provides that, in addition to the credits subject to the moratorium (listed above), the following credits shall be included in the Registry of Tax Credits:

    a. Tourism development credits;

    b. Film industry credits;

    c. Industrial tax credits;

    d. Credit for purchase of articles manufactured in Puerto Rico for local sale and consumption;

    e. Credit for purchase of articles manufactured in Puerto Rico for export;

    f. Credit for incremental purchases of agricultural products;

    g. Credit for purchase of automobiles propelled by alternative or mixed power;

    h. Tax credit program for purchase of newly constructed housing; and

    i. Tax credit program for purchase of existing housing.

  - The informative return is due on August 31, 2009, and it must include credits granted through June 30, 2009. Credits that are not included in the Registry of Tax Credits cannot not be subsequently claimed, except upon showing of reasonable cause for the noncompliance.

2. Property Taxes

- Special property tax

  - The duration of the imposition of the special property tax shall be limited to fiscal years 2009-10, 2010-11, and 2011-12, or until a total of $690 million is collected, whichever occurs first.

  - The tax rate is set at 0.591% of the appraised value of the property subject to the special property tax.

  - The property subject to the special property tax <u>includes</u> property used for <u>commercial purposes</u>. However, property exempted from payment of the property tax imposed by the Municipal Property Tax Act of 1991, as amended, by virtue of the same, or by any other act expressly providing for an exemption of property taxes, shall be exempt from the special property tax. Be advised that as drafted, commercial property would include property used by grantees of industrial tax exemption and concessionaires of exemption for tourist activities.

  - The term "real property used for residential purposes" is defined as any structure used as, or able to be used as, a residence, whether or not it is: (1) used by its owner as its principal residence; or (2) unoccupied; or (3) leased to a third party. The term excludes the following: (a) real property operated with federal funds under a governmental program; (b) real property constructed for a handicapped individual, certified by an engineer licensed to practice in Puerto Rico; or (c) a separate property constructed over a residence for which the owner receives no rent payments or any profit.

3. Excise Taxes

- Act 7 introduced the following changes to the Puerto Rico Internal Revenue Code of 1994, as amended ("Code"):

  - Cigarettes were subject to an increase on excise tax.

  - The definition of "automobile" included in the Code, was expanded to include "motorcycles." As a result, motorcycles were subject to the excise tax in the same manner as automobiles and were excluded from Sales and Use Tax ("SUT") provisions.

- Act No. 37 amended these provisions as follows:

  - Cigarettes imported to or manufactured in Puerto Rico for export are exempted from the imposition of the excise taxes.

  - The definition of "automobile" no longer includes "motorcycles." The terms "motorcycles" and "All Terrain Vehicles" were defined separately.

- A 10% excise tax is imposed on the taxable price in Puerto Rico of motorcycles and "All Terrain Vehicles." This provision becomes effective on August 1st, 2009.

4. SUT

- Act 7 introduced the following changes to the SUT provisions:

  - Credit for Purchases of Products Manufactured in Puerto Rico for Export – Merchants were no longer entitled to claim tax credits against the SUT for purchases of products manufactured in Puerto Rico for export. The credit may only be applied to offset income taxes imposed by Subtitle A of the Code. This amendment was effective immediately after Act 7 was approved.

  - Purchases for Resale – The reseller's SUT exemption was substituted by a SUT credit. All merchants purchasing in Puerto Rico taxable articles for resale will be unable to claim an exemption using the current certificate for exempt purchases, and will be required to pay SUT at the moment of purchase. Afterward, the reseller will be entitled to claim a credit for SUT previously paid on items for resale. The credit will be claimed in the monthly return corresponding to the same period in which the merchant paid SUT, and any unused credit excess may be carried forward to subsequent monthly SUT returns until exhausted.

  - Motorcycles and Scooters Taxable as Vehicles – discussed under section 4 "Excise Taxes," above.

- Act No. 37 amended these provisions as follows:

  - Purchases for Resale – "Collection of sales tax on sales for resale" of the Code was reinstated.

  - The certificate of exemption may be issued in the following circumstances, subject to compliance with the requirements imposed by the Secretary:

    a. Merchants with volume of business of $500,000 or more for existing businesses, or with an estimated volume of business of $500,000 or more for new businesses, purchasing taxable articles for resale;

    b. Merchants with volume of business below $500,000 purchasing taxable articles for resale;

    c. Manufacturing plants or persons eligible for any exemption provided in Subtitle BB of the Code

  - Introduces a new certificate of exemption for the 1.0% portion of the SUT collected by the municipalities for merchants that are not eligible for the certificate of exemption discussed above.

- The credit for taxes paid by the merchant shall not be used to offset the 1.0% portion of the SUT collected by the municipalities, but may be used to offset the 0.5% portion of the SUT collected by the Secretary as municipal tax.

5. International Banking Entities and Insurance Companies

- Act 7 includes a temporary 5% special income tax applicable to Insurance Cooperatives, Credit Union Cooperatives, International Insurance Companies and International Insurance Holding Companies, and International Banking Entities, which, until the enactment of Act 7, were tax exempt financial institutions. This special income tax shall be applicable for tax years 2009, 2010 and 2011; however, Act 7 did not specify the reporting guidelines for this tax.

- Act No. 37 provides that the special income tax shall be reported, paid and collected as provided in Subtitle A of the Code, which includes the Income Tax provisions.

- Act No. 37 further provides that the special income tax applicable to Cooperative Savings and Credit Associations shall be imposed for tax years 2009, 2010 and 2011, or until a total of $690 million is collected, whichever occurs first.

6. Alternative Basic Tax ("ABT")

As previously reported in our Spring 2009 edition of Tax Perspectives <http://www.mcvpr.com/CM/AboutPuertoRico/Tax_Perspectives%20Spring%202009.pdf>, one of the permanent changes introduced by Act No. 7 was the inclusion of many types of preferentially taxed, exempt or excluded income as part of the definition of "net income subject to Alternative Basic Tax".

Act No. 37 modified these provisions as follows:

- Net Income subject to ABT:
  - Interest from obligations issued by the Conservation Trust of Puerto Rico will not be included as part of net income subject to ABT.
  - Interest from obligations issued by the Housing and Development Trust of Puerto Rico will not be included as part of net income subject to ABT.
- Under Act 7 net income subject to ABT was taxed according to the following brackets:

If the Net Income Subject to the ABT is:	The applicable tax will be:
Of $75,000, but not greater than $125,000	10%
In excess of $125,000, but not greater than $175,000	15%
In excess of $175,000	20%

- As amended by Act No. 37, net income subject to ABT will be taxed under the following brackets:

If the Net Income Subject to the ABT is:	The applicable tax will be:
Of $75,000, but not greater than $125,000	10%
In excess of $125,000, but not greater than $175,000	15%
In excess of $175,000	20% <u>of the excess over</u> **<u>$125,000</u>**

The inclusion of the additional language provides relief to some taxpayers with Net Income Subject to the ABT in excess of $175,000 by introducing a progressive scale instead of a flat tax. As amended, a taxpayer with $170,000 in Net Income Subject to the ABT will be taxed $25,500 ($170,000 x 15%); while a taxpayer with $180,000 in Net Income Subject to the ABT will be taxed $29,750 (($125,000 x 15%) + ($55,000 x 20%)) for an effective tax rate of 17% instead of the flat 20% originally applicable.

- Act No. 37 also introduces two credit mechanisms that turn the ABT into a system more akin to the alternative minimum tax. These include: (1) the ability to offset the ABT by taxes paid in the U.S., its possessions, or foreign countries; and (2) the ability to credit the cumulative excess ABT payments over a taxpayer's regular tax liability towards the regular tax liability in subsequent years – in essence, treating the excess of ABT liability over the regular tax liability as a "pre payment" of future regular tax liabilities.

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