

February 6, 2014 www.mcvpr.com

TAX ALERT

New Regulations issued to Establish Criteria and Procedures Applicable to Requests for Partial Waiver from Gross Receipts Tax

On January 30, 2014, the Puerto Rico Treasury Department ("Treasury") issued regulations pursuant to Section 1023.10(a)(3) of the Puerto Rico Internal Revenue Code of 2011, as amended, (the "Code") to establish specific criteria to determine whether the application of the additional tax imposed under Section 1023.10 of the Code (the "Additional Tax") will result in prejudicial or undue economic consequence to a taxpayer that requests a partial waiver from said tax (the "Partial Waiver Request"). In such event, the regulations establish a procedure to determine a reduced substitute rate to be applied in lieu of the rate provided under the Code.

The regulations, comprised of new Articles 1023.10(a)(3)-1 through 1023.10(a)(3)-13 (the "Regulations"), became effective on January 30, 2014, pursuant to the emergency process of the Uniform Administrative Procedures Act ("UAPA"). However, the UAPA provides that after regulations issued pursuant to such process become effective, the agency must provide a period for comment. As a result, there is still opportunity for taxpayers to provide comments regarding the Regulations.

Below is a summary of the key provisions of the Regulations.

I. Definitions

The Regulations provide definitions to be used in the application of the same. Among the definitions are the following:

- Partial Waiver or "Dispensa"- the reduction in the applicable Additional Tax rate as provided under the Code and the Regulations, which amount cannot result in a rate lower than .05%.
- Gross Income- as defined under Section 1023.10(g)(1) of the Code.
 1. General Rule- gross income shall be as defined under Section 1031.02 of the Code, less the exemptions provided under Section 1031.02 of the Code. In the case of gains and income from the ordinary sale of real or personal property, the gross income of such business shall be the total generated from the sale of goods or products without deduction of the costs of such products.

Special rules apply in the case of insurance companies, gasoline stations, commission agents, brokers, representative agents, advertising agencies, distributors, automobile dealerships and contractors. Treasury reserves the right to modify gross income in the case of a financial business by means of a circular letter or administrative determination.

2. Exclusions - Among the exclusions from gross income are the following:

- Income from the operations covered by a grant, resolutions or concession of tax exemption issued pursuant to Act 73-2008, Act 74-2010, Act 83-2010, Act 20-2012, or any analogous, predecessor or successor law.
- Certain income derived from agriculture, certain income derived by tax exempt entities, portion of dividends from domestic controlled corporations, income from the conduct of a trade or business outside Puerto Rico, income from certain international insurers and certain international insurance holding companies, and income from financial businesses taxed as a partnership.
- Gross Margin on Gains- gross margin on gains is defined as net sales of real or personal property less the cost of said goods or products sold, as determined under US GAAP.
- Base Period- the term base period consists of the 4 taxable years (or such shorter period) in which the taxpayer carried out a business prior to the taxable year for which a Partial Waiver is being requested. Such period is to be utilized in the determination of the average Gross Income and the average Gross Margin for purposes of the evaluation of a Waiver Request.
- Report- refers to the agreed upon procedures report to be issued by a Puerto Rico certified CPA who participates in a Peer Review Program, which report must be prepared in accordance with official pronouncements issued by Treasury.

II. Taxpayers Eligible to Request Partial Waiver

Any taxpayer, other than a financial business, that meets the criteria and follows the procedures, both as established under the Regulations, may apply for a partial waiver ("Dispensa") from the Additional Tax (the "Partial Waiver").

The entity that may apply the criteria and follow the procedures to request a Partial Waiver depends on whether the taxpayer is taxed as a corporation, or is considered a conduit entity, for Puerto Rico income tax purposes; such as, a corporation of individuals, a special partnership or a partnership.

- Corporation- Any corporation, other than a financial business, subject to the Additional Tax and that meets the criteria may apply for a Partial Waiver.
- Conduit Entity- Although a determination of the Additional is made at the owner level (i.e., at the partner, member or shareholder level), the conduit entity shall be the one that may request a Partial Waiver on behalf of its partners, members or shareholders, as applicable.

The Regulations further provide that to be included in a Waiver Request to be submitted by a conduit entity, a particular partner, member or shareholder, must specifically submit a document to authorize the conduit entity to include such partner, member or shareholder in the Waiver Request. A copy of such document must accompany the conduit entity's Waiver Request.

III. Criteria for the Issuance of Partial Waiver

The regulations provide 'base criteria' for the issuance of a Partial Waiver. Such criteria entail a finding that the Additional Tax results in an amount considered significant in comparison to the Gross Margin of the taxpayer. The Additional Tax is considered significant in comparison to the Gross Margin when the Additional Tax represents an amount in excess of 7.5% of the Gross Margin during the Base Period.

IV. Procedure to Determine the Applicable Partial Waiver

A taxpayer that meets the criteria established in the Regulations may request a Partial Waiver within the periods established in the Regulations. Once a Waiver Request is filed, the regulations set forth the following procedural steps to determine the applicable Partial Waiver:

- Step 1- Treasury to verify that the request contains all of the information and documents required pursuant to the applicable circular letters and administrative determinations. Upon such verification, Treasury will evaluate the Waiver Request.
- Step 2- Treasury will compute the average of the Gross Income and the average of the Gross Margin of the Base Period reflected on the Report.
- Step 3- In the case of a taxpayer that is not a member of a controlled group or group of related entities, the average of the Gross Income will be multiplied by the tax rate applicable to the Additional Tax provided in Section 1023.10(a)(1) of the Code. In the case of a taxpayer that is a member of a controlled group or group of related entities, the average of the Gross Income will be multiplied by the tax rate applicable to the Additional Tax provided in Section 1023.10(e) of the Code. The product of said computation shall constitute the Additional Tax for the Base Period.
- Step 4- The Additional Tax for the Base Period shall be divided by the average of the Gross Margin of the Base Period to determine the percentage that the Additional Tax for the Base Period represents of the Gross Margin during the Base Period.
- Step 5- If the result in Step 4 is equal or less than 7.5%, the taxpayer will not have a right to a Partial Waiver. Treasury shall notify the taxpayer of said determination in writing.
- Step 6- If the result in Step 4 is greater than 7.5%, the taxpayer will have a right to a Partial Waiver. Treasury shall notify the taxpayer of said determination in writing.
- Step 7- Once a determination is made that a taxpayer has a right to a Partial Waiver, Treasury shall determine the reduced rate of the Additional Tax to be applicable to the 2 taxable years to be covered by the Dispensation Partial Waiver (the "Reduced Rate").
- Step 8- To determine the reduced rate, Treasury will divide the amount of the Base to Calculate the Reduced Rate by the Average Gross Income during the Base Period. The resulting percentage will be the reduced rate to be utilized by the taxpayer as the Additional Tax during the years covered by the Partial Waiver. For such purposes, the

Base to Calculate the Reduced Rate will be the greater of (i) 7.5% multiplied by the Gross Margin of the Base Period, as determined in Step 2, or (ii) .05% multiplied by the Gross Income of the Base Period, as determined in Step 2.

- Step 9- Treasury will notify the taxpayer that the Waiver Request has been approved including the amount of the reduced rate and the taxable years for which it will apply. A copy of such determination must accompany the income tax return of such years.
- Partial Waiver in cases of conduit entities- The computation referred to above shall be based on the financial information provided by the conduit entity on the Report included with the Waiver Request. If the Waiver Request is approved, Treasury shall inform to each partner, member or shareholder who elected to be included in the conduit entity's Waiver Request, of the Reduced Rate to be applied to determine the Additional Tax on such person's participation in the conduit entity's attributable Gross Income.

V. Deadline to file Waiver Requests

- Requests applicable to taxable year 2013- The deadline to file a request is extended to February 28, 2014.
- Requests applicable to taxable years commencing after December 31, 2013- A request must be filed no later than the last day of the taxable year for which a request for Partial Waiver is made.
- Special Rule: New Business- The deadline to file in the case of a request for the first taxable year of operations shall be no later than the last day of the third month following the close of the first taxable year.

VI. Evaluation of Waiver Requests

- Requests filed on or before November 30, 2013- Must be accepted or rejected no later than February 28, 2014.
- Requests filed after November 30, 2013- Must be accepted or rejected within 90 days after the request is filed. This rule applies to all requests regardless of the taxable year.
- Special Rule: New Business- Must be accepted or rejected within 90 days after the request is filed.
- Automatic Acceptance of a Request in the Event of No Response from Treasury within 90 Days of the Filing of a Waiver Request- Unless the 90-day period is interrupted, after the expiration of the 90 day period, an eligible taxpayer may compute the Additional Tax for the 2 years covered by the Waiver Request utilizing a rate of .1%.

VII. Information Necessary for Evaluation of a Waiver Request by Treasury

The regulations provide that a Waiver Request must include all of the information and documents required by Treasury.

- Incomplete applications- Special procedures are established in the event a Waiver Request is considered incomplete due to incomplete information or failure to include required documents

- Request for Clarification- Special procedures are also established for cases where the request is considered complete, but Treasury requests additional information to clarify any fact or information included in the request.

VIII. Payment of and Credit for Excess Additional Tax Paid

Every taxpayer subject to the Additional Tax must pay such tax for any taxable year, whether or not such taxpayer has requested a Partial Waiver for a particular taxable year and whether such request is pending a final determination.

In the event a taxpayer has paid the Additional Tax and, subsequent to such payment, the taxpayer is issued a Partial Waiver, the taxpayer may credit the excess of such Additional Tax paid against any income tax obligation, including the estimated tax.

IX. Term of Partial Waiver

A Partial Waiver and the accompanying Reduced Rate shall have an effectiveness of 2 taxable years, comprised of the taxable year for which the Partial Waiver was requested and the following taxable year.

X. Review of a Treasury Determination

A taxpayer who is not in agreement with a determination issued by Treasury may file an administrative complaint within 30 days from the date of the notification of Treasury's determination, to request an administrative review of said determination.

XI. Implication of the Filing of a Waiver Request by a Taxpayer who does not Meet the Criteria

In the event Treasury were not to issue a determination relating to a Waiver Request, the .1% tax rate will apply in the case of taxpayers who are eligible to request a Partial Waiver as determined under Article 1023.10(a)(3)-3 of the Regulations and who meet the criteria established in Article 1023.10(a)(3)-4 of the Regulations. Otherwise, Taxpayers who are not eligible to request a Partial Waiver and/or do not meet such criteria will not be eligible to apply the .1% tax rate.

For updates on this matter, you may contact any of the attorneys of our Tax Practice Group listed below:

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