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## TAX ALERT

***Phase One of the Puerto Rico 2010 Tax Reform and Establishment of Voluntary Declaration Program are Signed into Law / Phase Two of the Puerto Rico 2010 Tax Reform Already Before the Puerto Rico Legislature***

**Act Number 171 (Former House Bill Number 3028)**

On November 15, 2010, Governor Luis G. Fortuño signed into law House Bill 3028 as Act Number 171 ("Act 171"). Act 171 amends several sections of the Puerto Rico Internal Revenue Code of 1994, as amended ("Code"), as part of the first phase of the 2010 Puerto Rico Tax Reform. Please refer to our Tax Alert of November 3, 2010, which you may access here.

The following changes were made to House Bill 3028 ("Bill") before it became Act 171:

A. Allowance for Depreciation

As approved, Act 171 states that the depreciation deduction for certain tangible property will be determined using the straight-line method and the recovery period set forth in Section 1118 of the Code or, in cases where no fixed depreciation term is established by Section 1118, applying the provisions of the United States Internal Revenue Code analogous to Section 1118 of the Code and the regulations issued thereunder, until the Secretary of the Puerto Rico Treasury Department promulgates the corresponding regulations.

For tax years commenced after December 31, 2009, Act 171 amends the Code to allow a depreciation deduction for intangible property, other than goodwill, which is either acquired by purchase or developed. The Bill originally specified that the intangible property eligible for this depreciation deduction was property acquired by purchase or developed after September 1, 2010. As approved, Act 171 does not refer to any date. In addition, the Bill originally provided that the depreciation period would be 15 years. As approved, Act 171 provides that the depreciation period will be 15 years or the intangible property's useful life, whichever is less.

B. New Limit on Mortgage Interest Deduction

Act 171 amends the Code to limit the deduction for mortgage interest to 30% of the taxpayer's Adjusted Gross Income ("AGI") and any other income excluded from AGI. The inclusion of any other income excluded from AGI in the 30% limit computation was not part of the Bill as originally filed.

As approved, Act 171 amends the Code to establish two exceptions that were not part of the Bill as originally filed. First, this new limitation will not apply to taxpayers with interests payments below the 30% threshold of AGI and any other income excluded from AGI, for any of the 3 years prior to the year in which the deduction is claimed. Second, the limitation will not apply when the taxpayer or his or her spouse is 65 years or older at the end of the tax year.

#### C. New Credits for 2010

As originally filed, the Bill provided for certain income tax credits detailed in the table below and expressly stated that such credits were not refundable. As approved, Act 171 provides for the same credits included in the Bill as it was originally filed, but does not include a statement to the effect that such credits are not refundable, allowing them to generate a refund.

<b>Act 171: Additional Credit for 2010</b>	
<b>Adjusted Gross Income</b>	<b>Amount of Credit</b>
\$40,000 or less	15%
Between \$40,001 and \$100,000 (\$150,000 if the taxpayers are a married couple filing a joint return)	10%
Over \$100,000 (\$150,000 if the taxpayers are a married couple filing a joint return)	7%

#### D. New Informative Return Required (Credit Transactions)

Act 171 amends the Code to require that financial businesses file an informative return for certain credit approvals taking place after November 30, 2010 (the Bill required such return for transactions after September 30, 2010). Act 171 states that the required return will be known as "Affirmative Declaration of Transactional Amounts" ("Declaration"). In addition, Act 171 clarifies that the Declaration must be filed only when the application for credit is approved.

Other changes made included in Act 171 regarding the Declaration:

- (1) The Declaration will be required to report every credit transaction after November 30, 2010 (the Bill required the Declaration for every transaction after September 30, 2010);
- (2) The penalty for failure to file the declaration will be \$1,000 (the Bill provided that the penalty would be \$1,000 or 10% of the unreported amount, whichever was greater);
- (3) Includes a paragraph stating that no contractual, tort or criminal responsibility will be imposed on any person who files the Declaration in compliance with Section 1158 of the Code, as amended by Act 171.

#### E. Failure to Collect, Account For and Pay Withholding Taxes

##### (1) Felony

Act 171 amends the Code to establish that the act of voluntarily failing to collect, account for and pay withholding taxes constitutes a felony. The Act, however, does not include a section included in the Bill as it was originally filed, stating that such felony will not be subject to a statute of limitations.

##### (2) Penalties

Act 171 amends Section 6071 of the Code to increase the penalty imposed for failure to file the returns required by Code Sections 1141(j), 1141(n)(2), 1147, 1150, 1152(a), 1153, 1154, 1155, 1156(a), and 1157 from \$100 to \$500.

#### **Act Number 172 (Former House Bill Number 3029)**

On November 15, 2010, Governor Fortuño also signed into law House Bill Number 3029 as Act Number 172 ("Act 172"). Act 172 establishes a Voluntary Declaration Program to provide total exemption from the imposition of interest, penalties and surcharges related to the failure to report or the under-reporting of gross income subject to taxation under the Code and of volume of business subject to municipal license taxes under the Municipal License Tax Act of 1974, as amended, for taxable years commencing on July 1, 2003 and ending on December 31, 2009. Please refer to our Tax Alert of November 3, 2010.

#### **Phase Two of the Puerto Rico 2010 Tax Reform: House Bill 3070**

House Bill 3070 was filed on November 22, 2010 ("Bill 3070"). If enacted into law, it will become the Puerto Rico Internal Revenue Code of 2010, repealing the current Puerto Rico Internal Revenue Code of 1994.

If approved, Bill 3070 would bring about significant changes in the following areas:

- Corporate Reorganizations
- Determination of Gross Income
- Employee Benefits
- Excise Taxes
- Tax Rates
- Partnership Taxation
- Special Partnerships
- Special Property Tax

We will issue Tax Alerts highlighting the proposed changes affecting each of the areas identified above.

For updates on this matter, you may contact any of the attorneys listed below, all members of our [Tax Practice Group](#):

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