



# Tax newsletter

We want to be part of your success



In our last Tax newsletter, we provided you with the list of the recommendations issued by the CAREF to Puerto Rico Governor, Hon. Luis Fortuño. Since then, three pieces of legislation have been approved, with one related to private-public alliances still pending. The new legislation provides an economic framework to bring the Puerto Rico economy out of the current critical situation. We will concentrate on Act 7 which provides among other, several permanent and temporary provisions to increase tax collections.

When Act 7 was approved, we issued two Tax Updates summarizing the tax provisions. It is our understanding that some of the provisions are being intensively studied and that technical corrections to Act 7 will be issued

promptly within the next few weeks.

In this Tax newsletter, we will discuss the changes applicable to the calculation of the Alternative Minimum Tax (AMT) affecting individual taxpayers.

We also describe in this issue changes applicable to the computation of the AMT for corporations and other administrative matters being considered by the Puerto Rico Treasury Department.

The time to make a change has come. Measures to try to achieve that change have been presented and approved by our legislature. It is our turn now to evaluate such measures and provide our effort and cooperation to make them work for the benefit of our Puerto Rico.

**María de los A. Rivera**  
Tax Partner



Remember, **April 15** is the due date to file your 2008 PR and US individual income tax returns.

# New rules to compute alternative minimum tax (AMT) for individuals

As part of the permanent measures to increase collections included in Act 7 of March 9, 2009, a new methodology to compute the AMT in the case of individuals is established. This change is effective for taxable years commencing after December 31, 2008. According to official sources, the measure will increase collections by \$ 10,000,000 per year. Under the Puerto Rico Internal Revenue Code of 1994, as amended (The Code), prior to the approval of Act 7, the AMT was imposed upon the adjusted gross income without adding exempt income or income subject to special tax rates. The formula was basically:



Adjusted gross income (AGI)  
(income before deductions and personal exemptions)

Less : ordinary & necessary expenses  
Less: net long term capital gains  
Less: solar equipment deduction

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Alternative Minimum Taxable Income (AMTI)

The result was subject to the following rates, depending on the level of the AGI:

75,000 – 124,999	10%
125,000 – 174,999	15%
175,000 ---	20%

The individual tax payer would then compare his regular tax plus the recapture of the

lower tax brackets with the AMT, and pay the higher of the two.

Act 7 maintains the same tax rates, but the AMT is now imposed upon the “net income subject to AMT” (NIAMT).

The NIAMT is the net taxable income adjusted by the following: Exempt or partially exempt income (detailed below)

Adjustment in the distributive share in the income or loss of a special partnership engaged in installation, construction and building (the percentage of completion method will be used for AMT).

Adjustment to the deduction for mortgage interest: the deduction for AMT purposes will not exceed 30% of the NIAMT.

Act 7 enumerates the exempt or partially exempt income that will be added to the net taxable income in order to arrive to the NIAMT.

1. Interest income on:

- securities issued by virtue of the Agricultural Loans Act of 1971;
- mortgages secured under the provisions of the National Housing Act, approved June 27, 1934;
- obligations secured or guaranteed under the provisions of the Servicemen's Readjustment Act of 1944;
- mortgages on residential property located in Puerto Rico issued after June 30, 1983 and before August 1, 1997;
- mortgages on newly constructed residential property located in Puerto Rico issued after July 31, 1997;
- mortgages originated to provide permanent financing for the construction or acquisition of social interest housing;
- mortgages insured by the Secretary of Agriculture of the United States of America

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# New rules to compute alternative minimum tax (AMT) for individuals - continued

pursuant to the provisions of the Congress Bankhead-Jones Farm Tenant Act, approved July 22, 1937;

- certain long-term loans granted by insurance companies (other than life insurance companies);
- securities issued by cooperative associations;
- deposits in interest bearing accounts up to \$2,000;
- certain loans invested in the construction of buildings to be leased to the Government of the Commonwealth of Puerto Rico;
- obligations issued by (i) the Conservation Trust of Puerto Rico and (ii) the Puerto Rico Housing and Human Development Trust;
- loans granted to a special corporation owned by employees;
- loans granted to a person for the acquisition and payment of membership certificates in a special corporation owned by employees;

- loans granted for the purchase or investment by and for himself of preferred stock in a special corporation owned by employees;
- certain securities issued by corporations operating under the 1998 Tax Incentives Act“.

## 2. Other types of income:

- dividends received from industrial development income; rental income from buildings leased or rented to the PR government for the use as public hospitals and related as described in Sec. 1022(b)(8)(F);
- prizes in the Caribbean International Classic and Confraternity Cup Classic;
- stipends received by certain physicians during the internship period;
- literary, journalistic, scientific and artistic prizes, and prizes for industrial, agricultural, or professional development;

- distributions from limited dividends corporations;
- exemption to pensioners
- rental in historic zones;
- income and distributions from corporations or partnerships engaged in exportation;
- income and distributions from corporations or partnerships engaged in shipping activities;
- net capital gains taxed at special tax rates;
- dividends subject to special tax rates;
- interest in accounts subject to the special 10% rate;
- dividends from cooperative associations
- cost of living allowance (COLA);
- Christmas bonuses received by government pensioners;
- remuneration paid by baseball teams of Major League, associations and affiliated entities;

- income received or derived in connection with the holding of baseball games of Major League in Puerto Rico;
- remuneration paid by basketball teams of the National Basketball Association of the United States (also known as “NBA”), associations and affiliated entities;
- flexible benefits plans;
- interest subject to 10% rate pursuant Section 1013A;
- dividend or profit distributions received from a corporation or partnership which is an International Insurer; and
- income derived from distributions in total or partial liquidation of an International Insurer.

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# New rules to compute alternative minimum tax (AMT) for individuals - continued

Once the NIAMT is determined, the applicable rate is applied and the AMT is calculated. This AMT is then compared with the regular tax plus the recapture plus the following special tax rates:

- On dividends (Section 1012)
- On major league baseball players and NBA (Section 1012A, 1012B)
- On variable annuities (Section 1012B)
- On interest (Section 1013 – 1013A)
- On long term capital gains (Section 1014)



## Example\*

AGI	\$ 175,000
Net taxable income	150,000
Mortgage Interest	50,000
Exempt interest income	150,000
Exempt pension	30,000
Dividends subject to special rate	200,000
Interest subject to special rate	50,000

The regular tax on the income detailed above is **\$46,240**.

Pursuant to the new rules effective for calendar year 2009, the AMT will be calculated as follows:

Taxable income	\$ 150,000
Exempt interest	+ 150,000
Pension exclusion	+ 30,000
Special Rates income	+ 250,000
	\$ 580,000
	X .20%
AMT	\$ 116,000

As shown in the example, in the case of persons that receive a significant amount of exempt income and income subject to special rates, the AMT may represent a significant tax burden.

Both the professional community and officials from the Puerto Rico Treasury Department agree that some of these new provisions need to be reviewed given the negative impact these measures will have on some taxpayers and sections of the business community. For example, given the fact that the current AMT provisions for individuals do not provide for a credit of the AMT paid, the taxation of the distributive share in the income of a special partnership in the construction sector pursuant to the percentage of completion method will result in a double taxation of this income: once for AMT and a

second time for regular tax purposes when the contract is finalized.

At the moment, there are several technical amendments being considered. As soon as these are available we will share the same with you through our Tax Updates.

*\* The examples provided were prepared pursuant to the actual language contained in Act 7 and do not take into consideration any possible amendments that might be proposed.*

# Other new provisions contained in Act 7

As previously published in our Tax Updates, Act 7 contains several temporary and permanent provisions to increase tax revenue collections.

One of the temporary measures is the three year moratoria applicable to the use and issuance of several tax credits. As part of this moratoria, the Secretary of the Treasury must design and publish an informative return to be filed by the owners of any of the affected credits by May 30, 2009.

We were able to take a glance of a draft of the form. Besides including the eight types of credits listed by Act 7, the form also provides spaces requesting relevant information regarding other 10 types of tax credits. Even though owners of these other tax credits are not required to provide information, the Treasury Department is

appealing to them to comply with other requirements of information.

The form will ask for:

- act under which the credit was issued;
- amount of credit granted;
- amount available;
- amount used before 2009;
- unused amount; and
- intentions to sell.

Another temporary measure included in Act 7 was related to the computation of the AMT in the case of corporations and partnerships. Pursuant to this provision, the expenses paid by corporations or partnerships for services rendered outside Puerto Rico will not be deductible for AMT purposes. This provision was mainly directed to those management fees charged among related corporations. Therefore, it is understood that as part of the technical corrections being studied, this provision will only

apply to related parties charges, allowing the deduction only when the payment is made to unrelated third parties.

Act 7 also contains provisions requiring the monthly return filing and payment of the sales and use tax by the 10th of each month rather than the 20th.

In addition, it eliminates the exemption certificate in the case of wholesalers. These provisions were to be effective on April 1, 2009. It is our understanding that an Administrative Determination will be issued by the Secretary of the Treasury extending the effective date of all provisions related to the sales and use tax to May 1, 2009.

It is our understanding also, that the provisions related to the exemption certificate for wholesalers are being evaluated.

Once the technical corrections to Act 7 are published we will provide you a Tax Update on the most important changes included therein.



# Contact information

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