



# Tax newsletter

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After the approval of Act 7 and the amendments brought by Act 37, no major tax bills have being filed by our Legislature since July.

New filing dates for the Sales and Use Tax returns will become effective during the following next two months and the renewal process of certificate of exemption for resellers and manufactures is well on its way. Be aware and make the necessary changes on your calendars to comply with these new dates.

At Kevane we continue to monitor all tax related developments as part of our commitment to keep you posted as to any changes in tax rules that may affect the manner in which you conduct your business.

In this issue we summarize a recent case from the Puerto Rico Supreme Court dealing with the proper taxation for municipal excise taxes related to construction projects. In addition, we comment on the benefits of the Educational Savings Accounts and the approved changes in the application of the early retirement penalties on IRA's distributions. Finally, we provide an update on the recently approved bill related to the faculties granted to the Secretary of Treasury to waive certain penalties imposed by the Puerto Rico Internal Revenue Code.

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



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Remember to renew you Sales and Use Tax Certificate of Exemption if you are a reseller or manufacturer.

# Secretary of Treasury may waive certain penalties

After various reconsiderations, finally, P de la S 582 was enacted into law as Act No. 93 of September 10, 2009 (“Act 93”). In our June – July edition, we introduced Senate Bill 582 which granted faculties to the Secretary of the Treasury (“Secretary”) to abate the surcharges imposed by Section 6041 of the Puerto Rico Internal Revenue Code of 1994, as amended (“PRIRC”).

Nevertheless, these provisions were expanded to grant faculties to the Secretary to abate the surcharges imposed by other sections of the PRIRC. These new faculties will be available until June 30, 2010.

However, they may be extended for an additional year.

The following is a summary of the surcharges that could be abated by the Secretary as established by Act 93:

- **Section 6041(c)** -surcharges in connection with the tax determined by the taxpayer and surcharges related to deficiencies imposed by

**notices and requests** for payment from the Secretary. These surcharges range from 0% up to 10% depending on the timing of the payment.

- **Section 6041(d)** -surcharges in connection with **alcoholic beverages license** fees payment. These surcharges range from 30% to 100% of the corresponding annual fee.
- **Section 6045(a)** - surcharges in connection with **jeopardy assessments**. These surcharges range from 0% to 10% depending on the timing of the payment.
- **Section 6047(b)** - surcharges in connection with **bankruptcy and receivership notices and requests** from the Secretary. These surcharges range from 0% to 10% depending on the timing of the payment.
- **Section 6099(a) and (b)** - surcharges in connection with late payment of **excise taxes license fees**. These surcharges range from 0% to 10% depending on the timing of the payment.

In addition to the abatement of the surcharges, Act 93 grants the Secretary the faculties to abate the administrative fines imposed by Section 6099(a) and (b) which are 100% in case the taxpayer fails to renew the license or 200% in cases of recidivism.

It is important to mention that in order for the Secretary to abate the surcharges and fines imposed by Section 6099 of the PRIRC, the maximum amount of the license fees and/or the amount owed cannot exceed \$5,000.

This Act is in effect since its approval on September 10, 2009.



# Additional Relieve of Early Distribution Penalty on IRA's

Over the past years, Individual Retirement Accounts (IRA) have been a popular retirement savings vehicle in Puerto Rico.

One of the peculiarities of this mechanism is that it provides for the deferral of income tax payments on the contributions made for a taxable year, subject to certain limits and requirements.

To meet the main purpose of the IRA, which is to save money for the golden years, Section 1169(g) of the Puerto Rico Internal Revenue Code of 1994, as amended, establishes a 10% penalty on distributions or deemed distributions made to the taxpayer before attaining 60 years of age.

However, the early distribution penalty does not apply in the following situations:

- distributions due to disability;
- distributions due to loss of employment;
- distributions for the purchase or construction of the first principal residence;
- distributions for the repairs or reconstruction of a principal residence that has been affected by fire, hurricane, earthquake or other fortuitous causes;
- distributions up to \$1,200 for the purchase of a computer for use by a dependent, subject to certain rules; and
- distributions for the treatment of severe, chronic, degenerative and terminal illness of a family member, subject to certain rules.

In response to the actual economic crisis and to mitigate any possible mortgage execution

due to difficulties by the taxpayers in meeting mortgage payments due to the loss of employment or to a substantial reduction in revenues, the Governor signed Act No. 86 of August 20, 2009 ("Act 86"). Act 86 establishes that the 10% early distribution penalty will not apply in those cases where the taxpayer receives a distribution before attaining the age of 60, in order to avoid the imminent execution of the mortgage on a principal residence due to a default in the mortgage payments.

To avail the dispositions of Act 86, the taxpayer should present evidence of such need, circumstances and use of the funds. It is important to mention that the taxpayer will be able to retire 50% of the

deposited funds per financial institution or a total of \$20,000, whichever is higher.

This Act is in effect since August 20, 2009.



# Planning for the College Education of your Children?

Time passes very fast and kids grow in a blink of an eye. This is the reason why most parents begin to save for their children's education during the early years of the kids' life using different investment mechanisms.

If you are planning for your children's education as well, be aware that Section 1172 of the Puerto Rico Internal Revenue Code of 1994, as amended ("PRIRC") provides for the deferral of income tax payment on deposits made to an education contribution account, making it more attractive as an investment or savings alternative.

Deposits to education contribution accounts shall be made by persons that are related to the beneficiary up to the third degree of consanguinity or the second degree of affinity (i.e. brothers, sisters, nieces, nephews, grandchildren, etc.). However, it is important to mention that education contribution accounts

shall only be opened or established by the individual having the custody and patria potestas of the beneficiary for whom such account was created, or his/her authorized representative.

Contributions are limited to cash contributions up to \$500 per taxable year, per beneficiary.

On the other hand, distributions are made commencing on the date the beneficiary graduates from high school, or its equivalent, but not later than the end of the taxable year in which the beneficiary attains 30 years of age.

The funds available upon distribution shall be used to pay the following eligible post-secondary education expenses:

- tuition
- monthly payments, if any
- compulsory contributions to
- specific funds
- textbooks
- room and board.

- equipment or supplies required for completion of the corresponding courses
- expenses related to licenses or examinations required to perform the profession or occupation, and
- reasonable transportation expenses only if the studies are being held in the United States or abroad.

The term post-secondary education includes, among others, studies at universities, technical colleges, and vocational schools located in Puerto Rico, United States, or a foreign country and accredited by the education authorities of PR, US, or the corresponding country.

In order to request the distribution, the individual must provide the following documents:

- a certification issued by the post-secondary institution including a detail of the tuition costs;

- an invoice issued by the post-secondary institution. This invoice will be valid for 30 days only;
- a sworn statement indicating the amount of room and board expenses, textbooks, materials and supplies. This sworn statement will be valid for 6 months.

Finally, the total balance from the education contribution account shall be distributed to the beneficiary after having graduated from high school and not later than the taxable year in which he/she attains 30 years of age. The beneficiary shall include such distribution as gross income in the taxable year the payment is received. It is important to mention that the beneficiary can elect that a 17% income tax rate be withheld upon distribution.

# Supreme Court of PR Passes Judgment in Favor of Construction Company with Regards to Construction Excise Taxes

In *Municipality of Utuado vs. Aireko Construction Corp., Public Building Authority of PR* (Case #AC – 2008 -44) (hereinafter "the Case") the Supreme Court of Puerto Rico concluded that excise taxes on construction apply to the construction work itself and not to the contractor.

The Case states that the Public Building Authority of PR (PBA) was the owner of the construction project of the Vocational High School Luis Muñoz Rivera in the Municipality of Utuado ("Municipality"). As owner of the project, the PBA contracted Las Piedras Construction Corp. (LPC) to construct the school. LPC paid the corresponding excise taxes on the construction project to the Municipality.

Once the construction started, the PBA stopped the project with the intention to reduce costs, and

terminated the contract with LPC.

After the termination of contract, LPC did not request the corresponding refund of the construction excise taxes paid to the Municipality. For this reason, PBA requested to the Municipality to credit the excise taxes already paid on the project, to the account of the prospective contractor of such project.

Subsequently, PBA contracted with Aireko Construction Corp. ("Aireko") to continue the construction project. Nevertheless, the Municipality requested Aireko to pay the construction excise taxes on the project. Aireko did not pay such taxes and proceeded to file a claim on the Court of First Instance to leave without effect the Municipality's request.

The Court of First Instance granted the request concluding that the imposition of the excise

taxes applies over the project itself and not upon the contractor.

The Municipality did not agree with this decision and filed an appeal to the Court of Appeals. This Court concluded that the excise taxes on construction applies to the contractor and not to the project itself and consequently Aireko was responsible for the payment of such excise taxes.

Unsatisfied with the decision of the Court of Appeals, Aireko and PBA requested a certiorari to the Supreme Court of Puerto Rico ("Supreme Court").

Finally, the Supreme Court concluded in favor of Aireko and PBA stating that the excise taxes on construction where applicable to the project itself instead of the contractor. It is important to mention, that the Supreme Court clarified that if the excise taxes paid by another contractor were

reimbursed by the Municipality to the former contractor, then the new contractor will be responsible of the payment of the construction excise taxes.

The intention of the legislator when approving and amending the Autonomous Municipalities Act was to amplify the tax faculties of the municipalities. Nevertheless, the municipalities were not authorized, as part of the powers delegated by the Legislature, to collect more than once the construction excise tax on the same project.



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