



New Puerto Rico Tax Reform

Finally, after months of speculation, the Governor of Puerto Rico presented his bill related to the Tax Reform. House Bill 2329 known as “The Act to Transform the Tax System in the Commonwealth of Puerto Rico” was introduced in the Puerto Rico Legislature. The proposed legislation, once approved, will introduce a new Puerto Rico Internal Revenue Code of 2015. Following we summarize certain key aspects that this piece of legislation introduced:

- **Value Added Tax**

- The Tax Reform will mainly consist of the imposition of a Value Added Tax (IVA by its Spanish acronym) in substitution of the current sales and use tax system. The goal of the administration is that the tax be imposed to almost all of the consumption transactions with limited exceptions.
- In very broad terms, the IVA system works by imposing the tax at the beginning of the distribution chain and then each one of the members of the chain will claim a credit for the amount of tax already paid. The burden of the tax falls in the final consumer.
- The government has included in this proposed bill that the following items be excluded from the IVA imposition:
 - a. Non processed food and their ingredients
 - b. Sales of goods acquired with foods assistance programs
 - c. Sale of real property
 - d. Public education
 - e. Financial services (except bank charges) and insurance premiums
 - f. Residential housing leases, including student housing and
 - g. Medicines and articles for medical treatment
 - h. Medical services provided to holders of Medicare, Medicaid and the Puerto Rico government’s health insurance plan
 - i. Gasoline and related, already subject to other taxes
 - j. Leases subject to the tax imposed by the P.R. Tourism Company
 - k. Sale of articles used for agricultural purposes by bona fide farmers
 - l. Sale of vehicles and related, already subject to other taxes
 - m. Occasional sales of articles by religious organizations
 - n. Sales of articles and services provided to the government of PR and US, including agencies
- The proposed tax rate is 16%. The proposed bill establishes that the municipalities are prevented from imposing any type of consumption tax.

TAX REFORM

“The introduction of the IVA system will increase by 9% the tax rate already imposed by the sales and use tax”

- The proposed bill provides that a refund of all or part of the IVA will be available to persons with limited means. The manner of these refunds has not been established yet and the proposed bill did not establish the gross income thresholds, nor provides additional guidelines with regard to the refund process, except to say that the Secretary will issue additional guidelines. The only information provided in this regard is that the refunds are to be issued to eligible consumers during the months of November, March and July of each year.
- **The IVA is effective for years beginning January 1st, 2016 and thereafter. However, as a transitory disposition between the current Sales and Use Tax (SUT) system and the IVA, from April 1st to December 31, 2015, SUT provisions will remain in effect but subject to the 16% tax rate proposed for IVA purposes.**

● Income Tax Matters

- Another important change are the new income tax tables effective for the taxable year 2015 forward. In this regard, the first \$40,000 dollars, in the case of a single filer or the first \$80,000 dollars, in the case of married filers will be exempt from the imposition of income taxes. The personal income tax rates will be as follow:

Año contributivo 2015 y subsiguientes para contribuyentes individuales y para contribuyentes casados que rindan planilla conjunta y elijan el computo opcional

Si el ingreso neto sujeto a contribución fuere:	La contribución será:
No mayor de \$40,000	0 por ciento
En exceso de \$40,000, pero no en exceso de \$125,000	15% del exceso sobre \$40,000
En exceso de \$125,000 pero no en exceso de \$200,000	\$12,750 mas el 20% del exceso sobre \$125,000
En exceso de \$200,000	\$27,750 mas el 30% del exceso sobre \$200,000

Año contributivo 2015 y subsiguientes para contribuyentes casados

Si el ingreso neto sujeto a contribución fuere:	La contribución será:
No mayor de \$80,000	0 por ciento
En exceso de \$80,000, pero no en exceso de \$125,000	15% del exceso sobre \$80,000
En exceso de \$125,000 pero no en exceso de \$200,000	\$6,750 mas el 20% del exceso sobre \$125,000
En exceso de \$200,000	\$21,750 mas el 30% del exceso sobre \$200,000

“For a nation to try and tax itself into prosperity is like a man standing inside a bucket and trying to lift himself up by the handle” – Winston Churchill

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avoid to paid any type of tax.

- In addition, the 2% additional tax imposed to the professional services gross income and the alternate basic tax were eliminated.
- The following deductions will still be available to reduce the adjusted gross income for individuals:
 - a. Medical expenses
 - b. Donations (**only to P.R. entities**)
 - c. Losses of property for certain fortuitous causes
 - d. Individual retirement account
 - e. Interest paid over student loans
 - f. Contributions to retirement and pension plans
- The deduction for mortgage interest is eliminated and instead a non refundable credit against the income tax liability is enacted. The excess credit will not be creditable to future years and its amount will vary depending on the gross income reported. As an example, for persons whose gross income is less than \$125,000 the credit will be the lesser between 15% of the total mortgage interests paid or \$5,250.
- Capital gain and dividends will be taxed at a 30% rate.
- Corporations will also be subject to a 30% flat rate as well to the computation to the Alternative Minimum Tax (AMT). AMT tax rate is proposed to be 25%.
- A new Chapter 12 is introduced to the income tax revenue code that will uniform the tax treatment of flow through entities such as Special Partnerships, Limited liability Companies with flow through election, Partnerships and Corporation of Individuals. Under the proposed new code all domestic corporations may elect to be taxed as flow through entities.

● Final Thoughts

Public hearings about this topic will start next week. We will continue to monitor the progress of this significant matter and will render updated communications as soon as additional information is available.

Due to the significant changes that this new piece of legislation is proposing, we encourage everyone to start evaluating their tax structure in light of these proposed changes. Feel free to contact us to assist you.