

2011 Tax Reform: Corporate Income Tax

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A new Internal Revenue Code is in effect since January 31, 2011 for taxable years commencing **after December 31, 2010**.

The new code bring in important changes to individual, corporate, partnership, special partnerships and limited responsibility companies in Puerto Rico. Also it provides lower tax rates.

This bulletin will focus on principal changes that affect taxes for corporations, as follows:

1. Tax rate reductions

The new code establishes that all Corporations' taxpayers will be subject to a normal flat rate of 20%.

Also, corporations with taxable net income of more than \$750,000 will be subject to an additional tax rate of 30% maximum, computed as follows:

- From \$750,000 to \$1,750,000 = 5%,
- In excess of \$ 1,750,000 = \$87,500 + 10% of the excess of \$ 1,750,000.

For tax years commenced after December 31, 2013, the additional tax rate will be reduced by 5%, for a total tax rate of 25%. Prior to the new code, corporate taxpayers were subject to a maximum tax rate of 39%.

For controlled corporations or related entities, the additional tax rate will be determined by the **whole** group of entities' taxable net income.

It eliminates the special surcharge of 5% for corporations with net income subject to tax that exceeds \$500,000.

2. Alternative Minimum Tax

The alternative minimum tax rate is reduced from 22% to 20%. The New Code also modifies the tax to be the higher of:

- 20% of the alternative minimum taxable income, or
- 1% of the value of purchases of personal property from related parties.

The adjustment for payment of services performed outside of Puerto Rico by a related person that is not subject to tax in Puerto Rico continues to apply under the New Code as a permanent adjustment.

3. Tax treatment for partnerships

On the new code partnerships will not be taxable as separate entities from their partners. Partnership's income distributions will be taxable to the partners as individuals (pass-through).

For Limited Liability Companies, known as (CRL or LLC), will continue to be treated as corporations for tax purposes, but they can qualify to be treated as partnership for tax purposes if requested. Even though they can be treated as **partnerships, it will be mandatory for LLC's to be treated as partnerships on the United States or foreign countries for tax purposes.**

4. Other significant changes

The following changes also has been included on the new code:

- **The due date for return delivery will be the (15) fifth teen day of the third (3) month following the tax year end for partnerships, special partnerships,**

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individual corporate and limited liability companies. For example: If the year ends as of December 31, the tax return will have a due date of March 15 of the following year.

- It will eliminate for 2011 the special surtax of 5% for some corporations.
- It will increase the vehicle depreciation deduction from \$5,000 annually to \$6,000 annually; the maximum base of the vehicle will increase to \$30,000, instead of \$25,000. For salesman taxpayers it will be permitted a maximum deduction of \$10,000 annually up to a maximum of \$30,000 for vehicle.
- The expenses of repair and maintenance of vehicles will not be deductible, instead it will be accepted a deduction for the vehicle use computed on millage use by the standard rate.
- **It will not be permitted to apply for an election to be taxed as special partnership from January 1, 2011.**
- It will be required Audited Financial Statements to entities with business income volume greater than **\$3,000,000**, including special partnerships and individual corporations, which previously were required

to be audited if volume was greater than \$500,000. Entities with a business volume between \$1,000,000 and \$3,000,000 will have the option to present audited financial statements in order to make them eligible for a total exemption on the withholding from service income. Also, to be eligible, it will have to be updated with the tax responsibility.

- All groups of related entities that are dedicated to business or industry on Puerto Rico will be required to present **consolidated financial statements** under accounting principles generally accepted in the United States of America (“US GAAP”).
- Corporations, partnerships and limited liability companies, will have the irrevocable option to be taxed under previous code for a period of five years beginning on 2011. The taxpayer will make the election filing the first Income Tax Return for tax year beginning after December 31, 2010 and before January 1, 2012. Once the option has been elected, it will be **final and irrevocable** for the tax year in which it has been elected and for the following taxable four years.

Soon, we will be providing additional information on other changes established on this tax reform.



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