FERRAIUOLI LLC

Taxes & Employee Benefits

July 8, 2014

NOTICE TO CLIENTS AND FRIENDS

New Puerto Rico Tax Changes that affect Corporate and Individual Taxpayers

The Governor of the Commonwealth of Puerto Rico has signed Act 77 of July 1, 2014 (the "Act") into law. The Act includes multiple amendments to the Puerto Rico Internal Revenue Code of 2011, as amended (the "Code") that will have a direct impact on the tax liabilities of individual and corporate taxpayers. Many of the changes are effective during the year 2014, some of them on a retroactive basis, and some effective as of July 1, 2014. The most significant changes resulting from the Act are as follows:

<u>Changes to the Code</u>

1. **Alternate Basic Tax bracket** - The Alternate Basic Tax bracket for tax years commencing after December 31, 2013 was modified to accelerate the phase-in of the higher Alternate Basic Tax rates, with the maximum 24% Alternate Basic Tax rate applying to individuals with an Alternate Basic Taxable Income of $300,000 (previously $500,000 for years beginning prior to January 1, 2014);

2. **Credit for prior year Alternate Basic Tax payments** - The credit for prior year Alternate Basic Tax payments was limited to 25% of the excess of the Regular Tax over the Alternate Basic Tax, and may only be claimed with respect to the Alternate Basic Tax paid for tax years ending on or before January 1, 2014 (no such limit existed for years beginning prior to January 1, 2014);

3. **Individual Long-term capital gains** - The long-term capital gains tax rate for individuals was increased to 15% (from previous 10% rate) for all transactions occurring after June 30, 2014;

4. **Corporate alternative tax over long-term capital gains** - The corporate alternative tax over long-term capital gains was increased to 20% (from previous 15% rate) for all transactions occurring after June 30, 2014;

5. **Individual Dividend Distribution Tax Rate** - The preferential individual tax rate on dividend distributions was increased to 15% (from previous 10% rate) for all eligible distributions occurring after June 30, 2014;

6. **Gross Receipts Tax** - The Act introduced the following changes to the Gross Receipts Tax ("GRT"):

   a. For taxable years beginning before January 1, 2014, the GRT will continue to be treated as part of the taxpayer's alternative minimum tax and/or alternate basic tax liability.

   b. For taxable years beginning after December 31, 2013, the Gross Receipts Tax ("GRT") will no longer be treated as part of the taxpayer's alternative minimum tax and/or alternate basic tax liability. Although the GRT will be an additional tax over the taxpayer's gross income, it will be deductible for purposes of computing taxable income, but only to the extent that the GRT is paid on or before the filing date of the income tax return.

   The GRT tax rates for taxable years beginning before January 1, 2014 will be as follows:

Gross Income	Tax Rate
$1,000,000 to $3,000,000	0.20%
In excess of $3,000,000 up to $300,000,000	0.50%
In excess of $300,000,000 up to $600,000,000	0.70%
In excess of $600,000,000 up to $1,500,000,000	0.80%
Over $1,500,000,000	0.85%.

   c. The GRT tax rates for taxable years beginning after December 1, 2014 will be as follows:

Gross Income	Tax Rate
$3,000,000 to $100,000,000	0.35%
From $100,000,000 up to $300,000,000	0.50%
From $300,000,000 up to $600,000,000	0.70%
From $600,000,000 up to $1,500,000,000	0.80%
Over $1,500,000,000	1.00%.

   d. In the case of taxpayers that are retailers principally engaged in the sale of non-prepared food products and with a gross income that is less than $400,000,000, the GRT tax rates for taxable years beginning after December 1, 2014 will be as follows:

Gross Income	Tax Rate
$3,000,000 to $300,000,000	0.20%
In excess of $300,000,000 up to $400,000,000	0.28%

7. **Prepayment of Tax on Eligible Variable Annuity Contracts** -Individual owners or beneficiaries of life insurance policies or annuity/endowment contracts that, on or before December 31, 2014, exchange said policies or contracts for an "Eligible Variable Annuity Contract" may elect to prepay, in lieu of any other tax, an amount equal to 10% of the undistributed amounts accumulated under the exchanged policies or contracts that would have otherwise been subject to income taxes in Puerto Rico;

8. **Individual Election for Special Income Tax on the Gains from the Sale (or Accumulated Increase in the Value) of Certain Assets** - Individuals, estates and trusts may elect to pay a reduced Puerto Rico income tax rate on any gains resulting from the sale of long term capital assets or as a prepayment on all or part of the accumulated increase in the value of certain assets, regardless of whether they are actually sold. The applicable preferential rate will be 8% in the case of capital assets or 15% in the case of other included assets that are otherwise taxable at ordinary income tax rates.

   The prepayment election will be available only with regards to (i) shares of corporate stock or membership interests in domestic or foreign corporations, partnerships or limited liability companies; (ii) real property within and without Puerto Rico, including property subject to a depreciation allowance, provided that any increase in the adjusted basis of a depreciable asset will only apply to a future sale of the asset and not to the computation of the future depreciation allowances; provided that any increase in the adjusted basis of a depreciable asset will only apply to a future sale of the asset and not to the computation of the future depreciation allowances; (iii) fixed annuity contracts, and (iv) amounts accumulated under a qualified or non-qualified employee pension plan. The election, in all applicable cases, must be made during the period from July 1, 2014 until October 31, 2014;

9. **Corporate Election for Special Income Tax on the Gains from the Sale (or Accumulated Increase in the Value) of Certain Capital Assets** - Corporations may elect to may elect to pay a reduced Puerto Rico income tax rate on any gains resulting from the sale of long term capital assets or as a prepayment on all or part of the accumulated increase in the value of certain assets, regardless of whether they are actually sold. The applicable preferential rate will be 12% in the case of capital assets or 15%.

   The prepayment election will be available only with regards to (i) shares of corporate stock or units of membership interests in domestic or foreign corporations or partnerships; (ii) real property within and without Puerto Rico, including property subject to a depreciation allowance provided that any increase in the adjusted basis of a depreciable asset will only apply to a future sale of the asset and not to the computation of the future depreciation allowances; and (iii) intangible assets such as patents and goodwill. The temporary window in all applicable cases is from July 1, 2014 until October 31, 2014

10. **Individual Prepayment of Income Tax on IRAs** - Individuals may elect to prepay an amount equal to 8% of any undistributed amounts accumulated under Puerto Rico individual retirement accounts. The prepayment must be made on or before October 31, 2014. Taxpayers electing to prepay the 8% tax will be subject to a 30% penalty on any amounts withdrawn from their IRA accounts received prior to their 60th birthday (generally 10% otherwise), except in the case of distributions that are made to pay the special 8% rate;

11. **Long Term Asset Holding Period** - The long term asset holding period for capital assets sold after June 30, 2014 was increased to 1 year. In addition, the amount of capital losses that may be used to offset capital gains was limited to 90% of the capital gains and the carry forward period for net capital losses realized during any taxable year beginning after December 31, 2013 was extended to 7 years (capital losses realized before 2006 were allowed a 5 year carry forward, capital losses after December 31, 2005 and before December 31, 2012 were allowed a carry forward of 10 years);

12. **Credit for Prior Year Alternate Minimum Tax Payments** - The credit for prior year Alternate Minimum Tax payments was limited to 25% of the excess of the Regular Tax over the Alternate Minimum Tax;

13. **Maximum Amount of Tax Credits** - New limits were established on the maximum amount of Tax Credits that may be approved for certain projects under Act 212-2002 to $15,000,000 per project for the fiscal year 2013-14 and to $5,000,000 for fiscal years 2014-15 and 2015-16;

14. **Earned Income Credit** - The Earned Income Credit was eliminated for taxable years commencing after December 31, 2013;

15. **Credit for Persons Older than 65 years** - The amount of the credit for persons older than 65 years was reduced to $200 (previously $400). The amount of the credit would increase to $400 if the tax revenues of the General Fund exceed the projected tax revenues by at least $100,000,000;

16. **Withholding at Source on Service Payments** - The requirements on withholding on service payments (generally 7%) was modified to specifically exclude insurance premiums. Additionally, the Act clarifies that income or gains generated by direct salespersons of consumer products, will not be subject to income tax withholding. In this sense, the Act defines the term "direct salespersons" to exclude any person that receives commissions or other payments that represents, in whole or in part, income or gain generated by a direct salesperson or other type of vendor under the supervision, control, management, or is a member of the distribution network of such person;

17. **Implicit Dividend Tax** - Imposed of a 10% Implicit Dividend Tax on the earnings and profits of certain corporate taxpayers that are owned by foreign persons and own Non-Puerto Rico Assets that exceed their accumulated earnings and profits. The 10% Implicit Dividend Tax will be credited to the withholding tax on future dividends;

18. **Annual license fees** - Imposed a $2,500 annual license fee on each adult entertainment coin operated machine;

<u>Changes to Act 73</u>

1. Section 2 of Act 73 currently defines a "Small or Mid Size Company" as a company that has generated a gross income of less than $10,000,000 during the three prior years of operation. The Act modified this definition to exclude any companies that meet this requirement but are also members of a controlled group with sales in excess of $10,000,000;

2. Section 5 of Act 73 was amended to impose new procedural requirements for companies that claim the research and development ("R&D") tax credit. In order to claim the credit, the Companies must now request and obtain, prior to filing their income tax return, a certificate from the Puerto Rico Industrial Development Company ("PRIDCO") that validates that the activities for which the credit will be claimed are eligible R&D activities under Act 73. The maximum amount of R&D credits was also limited to $300,000,000 per year;

Changes to Act 83

1. Article 2.2 was amended to reduce to $20,000,000 per year the allocation of funds to the Puerto Rico Green Energy Fund for the fiscal years 2014 through 2020;

This document has been prepared for information purposes only and is not intended, and should not be relied upon, as legal advice. If you have any questions or comments about Act #77, wish to obtain more information related thereto, or about its possible effect(s) on policy or operational matters, please contact us.

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