O'NEILL & BORGES LLC

TAX ALERT

THE TAX CUTS & JOBS ACT

DECEMBER 2017

Recently-approved federal tax reform will have notable impact on business operations in Puerto Rico

The Tax Cuts & Jobs Act, which final version was approved in the U.S. House and the Senate on December 20, 2017, introduces important changes to the federal tax regime affecting individuals, corporations, partnerships and businesses in general. The legislation will also have notable impact on business operations in Puerto Rico.

The following are some highlights:

1. The corporate income tax rate is reduced to 21%. Alternative minimum tax is repealed, effective taxable years beginning after December 31, 2017.

2. With certain exceptions, the deduction for interest expense is limited to 30% of the US debtor's adjusted taxable income.

3. An immediate write-off (full expensing) is allowed with respect to property acquired by a taxpayer between September 29, 2017 and December 31, 2022, provided the property has a recovery period of 20 years or less.

4. Net operating losses generated in 2018 and thereafter may be carried-forward indefinitely, but the deduction will be limited to 80% of taxable income with respect to post-2017 losses. The carry-back of net operating losses is eliminated.

5. In the context of the international tax regime, which is of particular interest to Puerto Rico operations with US Shareholders, the tax regime will move from a worldwide system of taxation to a participation exemption regime:

(a) A 100% deduction is allowed for dividends received by a domestic corporations that is a US Shareholders (10% or more owners) of a Specified Foreign Corporation (any foreign corporation that has a US Shareholder). The deduction applies with respect to the foreign-source portion of the dividend distributed by the Specified Foreign Corporation. This deduction will apply to distributions made after December 31, 2017.

(b) A US Shareholder of a Specified Foreign Corporation will be required to include in gross income the accumulated and untaxed earnings and profits as of November 2, 2017 or December 31, 2017 (greater amount). Considering deductions included in the bill, the effective rate on this imputed distribution will be 15.5% with respect to earnings and profits held in cash and cash equivalents and 8% with respect to earnings and profits invested in other assets. The US Shareholder may elect to pay the tax on the imputed dividends in eight installments.

(c) A minimum tax is imposed on Global Intangible Low Tax Income (GILTI):

Tax reform targets US Shareholders of Controlled Foreign Corporations (CFCs)

A US Shareholder of a Controlled Foreign Corporation (CFC) will be obligated to include in gross income the excess of the CFC's income over a routine or expected return on the CFC's qualified business asset investment. Such excess (GILTI) is assumed to be a return on intangible property subject to low foreign tax rates, and thus, subject to federal income taxes under the bill. A CFC is a foreign corporation that is at least 50% owned by US Shareholders (owners of 10% or more). This tax will apply to taxable years of a foreign corporation beginning after December 31, 2017, with respect to the returns of US Shareholders in which the taxable year of such foreign corporation ends.

Considering the new deductions allowed (see next point), corporate US shareholders will be subject to an effective tax rate of 10.5% on GILTI; such rate to be increased to 13.125% for years commenced after December 31, 2025. Note that US shareholders who are not corporations will not be allowed the deduction below, so they will be subject to federal income taxes on GILTI at the applicable rates.

(d) Deduction for domestic corporations with respect to Foreign Derived Intangible Income Deduction (FDII) and Global Intangible Low-Taxed Income (GILTI)

A US corporation is allowed a special deduction that results from the sum of specific percentages of FDII and GILTI. FDII is the intangible income of a US corporation that results from serving foreign markets. GILTI is as defined above. Assuming a corporate tax rate of 21%, the effective tax rate of FDII will be 13.125% and the effective tax rate of GILTI for a US corporation is 10.5% for taxable years beginning after December 31, 2017 and before January 1, 2026. The effective tax rate of FDII for years commencing after December 31, 2025 is 16.406%. This deduction is applicable for taxable years commenced after December 31, 2017.

(e) A Base Erosion Anti-Abuse Tax (BEAT) is imposed on certain deductible amounts accrued or paid by applicable taxpayers to foreign related persons. Applicable taxpayers are US corporations (or foreign corporations that are engaged in a trade or business in the US), that are part of a group with annual domestic gross receipts of $500M or more and that make base erosion payments constituting at least 4% of their total deductions. The effective rate of BEAT is 10%, and it will increase to 12.5% for taxable years commencing after December 31, 2025. Note that a 25% common ownership threshold is established in this context to determine if the payments occur between related persons. The BEAT is applicable to taxable years commencing after December 31, 2017.

(f) The definitions of US Shareholder and Controlled Foreign Corporation have been modified to expand their scope.

(g) Transfers of partnership interests by foreign partners are now subject to federal income taxes if the transferred partnership was engaged in a trade or business in the US. Withholding obligations are imposed with respect to such transactions.

6. The treatment of partners and partnerships has suffered several changes. For example, individual partners may deduct 20% of the qualified business of a partnership, S corporation or sole proprietorship, but note that certain business activities will not give rise to this deduction. Note that income derived by a partnership from Puerto Rico operations is generally included in the qualified business of the US partners if the partnership income was taxable under the US Internal Revenue Code.

Puerto Rico continues to be considered a foreign jurisdiction for purposes of the US Internal Revenue Code

Puerto Rico continues to be considered a foreign jurisdiction for purposes of the US Internal Revenue Code, and thus, it is expected that the international provisions described above will impact Puerto Rico operations that are owned by US Shareholders. The private sector and the government of Puerto Rico had proposed partial or total exemptions for Puerto Rico operations with respect to the tax on GILTI, the BEAT, and the imputed repatriations described above. Such efforts are expected to continue in connection with other legislation vehicles.

O'NEILL & BORGES LLC
Tax Group

Members:
Ivelisse Collazo
Giselle Flaqué
Rosa M. González
Amaya Iraolagoitia
Michelle Marichal
Cristina Morazzani
Samuel Rosado
Ismael Vincenty

Associates:
Edgardo López
Denisse Ortiz
Christopher Rivera
Francisco Rodríguez
Roxanna Santiago
Suhaily Sepúlveda

Of Counsel Walter F. Chow

O'NEILL & BORGES LLC

250 Muñoz Rivera Ave., Suite 800
San Juan, Puerto Rico 00918-1813
Tel.: 787-764-8181

www.oneillborges.com