

(H. B. 1265)
(Conference)

(No. 40)

(Approved August 1, 2005)

AN ACT

To amend subsection (a), eliminate subsections (b), (c), (d), (e), and (g). to amend subsection (f) and redesignate it as subsection (b) of Section 1014; to amend paragraph 29 of subsection (b) of Section 1022; to amend paragraph (2) of subsection (c) of Section 1121; and to amend paragraph (1) of subsection (g) of Section 1147 of Act No. 120 of October 31, 1994, as amended, known as the “Puerto Rico Internal Revenue Code of 1994,” in order to make uniform the tax rates imposed on long-term capital gains.

STATEMENT OF MOTIVES

Since 1987, tax laws in Puerto Rico levied a special twenty (20) percent tax rate on long-term capital gains. in the case of individuals, estates, and trusts. At the time of the approval of the Puerto Rico Internal Revenue Code of 1994, as amended, (hereinafter the “Code”) said rate was kept.

Act No. 24 of April 11, 2001 amended several provisions of the Code to reduce the tax rate imposed on long-term capital gains generated from the sale or exchange of property located in Puerto Rico from twenty (20) percent to ten (10) percent in the case of individuals, estates, and trusts; and from twenty-five (25) percent to twelve point five (12.5) percent in the case of corporations and partnerships. On the other hand, Act No. 226 of August 22, 2004, reduced in fifty (50) percent the special rates applicable to long-term capital gains in the case of capital assets transactions executed during the period comprising from July 1, 2004 to June 30, 2005. Both measures were

adopted with the manifest purpose of promoting investments in Puerto Rico and the development of capital markets on the Island.

It is evident that the provisions of law described above have failed to fully comply with their purpose, yet have benefited a group of taxpayers, who have been able to execute transactions to benefit from the reduced rates. In Puerto Rico, the tax burden mostly falls in the wage-earning worker. However, the wage-earning worker has not benefited from these measures. It must be considered that the greatest investment made by the wage-earning worker is in his/her dwelling. However, taxation on gains that could be made in the sale or exchange of his/her dwelling can be postponed by the taxpayer, in most cases, when purchasing another dwelling under other provisions of the Code. Only taxpayers who have amassed their wealth in properties and investments were able to take advantage of the opportunity to pay taxes on the capital gains at low rates such as five (5) percent; and for whom once again, a window of opportunity opened so that they would not have to assume their proportional share of the Puerto Rico tax burden.

After a thorough analysis, it has been determined to eliminate reduced rates and make the rate of the long-term net capital gain uniform for both, individuals and corporations, that is, twelve point five (12.5) for individuals and twenty (20) percent for corporations.

BE IT ENACTED BY THE LEGISLATURE OF PUERTO RICO:

Section 1.- Subsection (a) is hereby amended, subsections (b), (c), (d), (e), and (g) are hereby eliminated, and subsection (f) is hereby amended and redesignated as subsection (b) of Section 1014 of Act No. 120 of October 31, 1994, as amended, known as the “Puerto Rico Internal Revenue Code of 1994,” to read as follows:

“Section 1014.- Special Taxes to Individuals, Estates, and Trusts on Net Long-Term Capital Gains.-

- (a) Twelve point five (12.5) percent tax rate.—Any individual, estate, or trust shall pay, in lieu of any other taxes imposed by this Subtitle, a twelve point five (12.5) percent tax on the excess amount of any net long-term capital gain on any net short-term capital loss, as said terms are defined in Section 1121, or may choose to include said gain as part of its gross income on the income tax return of the year said gain is acknowledged, and pay taxes according to the normal tax rates, whichever is of greater benefit to the taxpayer.
- (b) Form of Payment.—The tax imposed by subsection (a) shall be paid as provided in Sections 1059 and 1060.”

Section 2.- Paragraph (29) of subsection (b) of Section 1022 of Act No. 120 of October 31, 1994, as amended, is hereby amended to read as follows:

“Section 1022.—Gross Income.—

(a) ...

(b) Exclusions from Gross Income.—The following items shall not be included in the gross income and shall be exempted from taxation under this Subtitle:

(1) ...

(29) Net Capital Gains.—The net long-term capital gain subject to the twelve point five (12.5) percent tax provided in Section 1014.”

(c) Alternative Tax in the Case of Corporations and Partnerships.—

(1) ...

(2) An amount equal to twenty (20) percent shall then be determined.

Section 3.- Paragraph (2) of subsection (c) of Section 1121 of Act No. 120 of October 31, 1994, as amended, is hereby amended to read as follows:

“(a) ...

(c) ...”

Section 4.- Paragraph (1) of subsection (g) of Section 1147 of Act No. 120 of October 31, 1994, as amended, is hereby amended to read as follows:

“Section 1147.— Withholding at Source of the Tax in the Case of Nonresident Individuals.—

(a) ...

(g) Special Rule in Cases of Sale of Property by Nonresident Persons.—

(1) Obligation to Withhold.—Notwithstanding any other provisions of this Subtitle, a person who acquires real property or shares from any nonresident person (if the profit made in the transaction constitutes income from sources in Puerto Rico) shall deduct and withhold twelve point five (12.5) percent of the payments he/she makes to the nonresident person during the current tax year or in subsequent tax years as part of the purchase price of said property. Such withholding shall be of the same nature, and be declared and paid to the Secretary in the same manner and subject to the same conditions provided in the other subsections of this Section. When the recipient is an individual who is a United States citizen, the withholding

provided herein shall be of twelve point five (12.5) percent.”

Section 5.- The moneys received pursuant to the provisions of this Act for fiscal year 2005-2006 that exceed the sum of thirty one million dollars (31,000,000) shall be covered in a special fund to be created by the Department of the Treasury to be used in accordance to the budgetary needs of the Government of Puerto Rico through a Joint Resolution to such ends.”

Section 6.- This Act shall take effect on July 1, 2005 and shall be applicable with respect to transactions conducted in tax years commencing after June 30, 2005. This Act shall be effective until June 30, 2007 subject to the approval of the Joint Resolution of the General Budget of 2006.

CERTIFICATION

I hereby certify to the Secretary of State that the following Act No. 40 (H.B. 1265) (Conference) of the 1st Session of the 15th Legislature of Puerto Rico:

AN ACT to amend subsection (a), eliminate subsections (b), (c), (d), (e), and (g). to amend subsection (f) and redesignate it as subsection (b) of Section 1014; to amend paragraph 29 of subsection (b) of Section 1022; to amend paragraph (2) of subsection (c) of Section 1121; and to amend paragraph (1) of subsection (g) of Section 1147 of Act No. 120 of October 31, 1994, as amended, known as the “Puerto Rico Internal Revenue Code of 1994,” in order to make uniform the tax rates imposed on long-term capital gains,

has been translated from Spanish to English and that the English version is correct.

In San Juan, Puerto Rico, today 1st of February of 2006.

Francisco J. Domenech
Director

