

(H.B. 1300)

(No. 48)

(Approved January 30, 2006)

AN ACT

To amend clause (1) of subsection (a), amend clause (1) of subsection (b), add a paragraph (B) to clause (2) of subsection (b) and amend paragraph (A) of subsection (c) of Section 1013A; amend clause (10) of subsection (a) of Section 1024; and add a clause (51) to subsection (b) of Section 1022 of Act No. 120 of October 31, 1994, as amended, known as the “Puerto Rico Internal Revenue Code of 1994,” to clarify that the investment of the product of bonds, notes and other obligations whose interest is eligible under Section 1013A(b)(1) may be made in subsidiaries; include as part of the interest described in Section 1013A(b)(2) the shares in trusts that represent an interest in mortgage loans on residential property located in Puerto Rico whose interest is not exempt under Section 1022(b)(4); include the language of the amendment to Section 1022; and limit the deduction of expenses incurred in the interest on loans whose product is invested in obligations whose interest is eligible under Section 1013A(b) for the tax rate of ten (10) percent.

STATEMENT OF MOTIVES

Act No. 239 of September 3, 2003, amended Sections 1013A and 1022 of Act No. 120 of October 31, 1994, as amended, known as the “Puerto Rico Internal Revenue Code of 1994,” for the purposes of including the corporations and partnerships within those taxpayers that are eligible for the special tax rate on the interest accrued on the debt of corporations and partnerships devoted to industry or to conducting business in Puerto Rico

and certain mortgage loans on residential property located in Puerto Rico and to reduce to ten (10) percent the special tax rate regarding the interest described in Section 1013A.

Upon analyzing these amendments it becomes necessary to clarify their language and scope and correct certain aspects of the same. It also becomes necessary to adopt language that eliminates the possibility of making earnings, directly or indirectly, through the practice of incurring in a debt when possessing or investing in bonds, notes, obligations or mortgage loans subject to the special tax rate of ten (10) percent.

This Act also establishes that the special tax rate of ten (10) percent shall be applicable to shares in trusts which represent an interest in mortgage loans on residential property located in Puerto Rico whose interest is not exempt under Section 1022(b)(4) of the Code. This Legislature believes that the application of the special rate to said shares shall help promote the market sales of these mortgages in Puerto Rico which at present is mainly developed outside the Island due to the tax rate to which they are subject.

To those ends, the Legislature of Puerto Rico deems it necessary to approve legislation to: (i) make clear that the investment of the product of the bonds, notes and other obligations whose interest is eligible under Section 1013A may be made in subsidiaries; (ii) to include as part of the interest described in Section 1013A(b) the shares in trusts that represent an interest in mortgage loans on residential property located in Puerto Rico whose interest are not exempt under Section 1022(b)(4); (iii) include the language of the amendment to Section 1022; and (iv) amend Section 1024 to eliminate the possibility of generating earnings with the ten (10) percent thus incurring other debts.

BE IT ENACTED BY THE LEGISLATURE OF PUERTO RICO:

Article 1.-Clause (1) of subsection (a) and paragraph (A) of subsection (c) of Section 1013A of Act No. 120 of October 31, 1994, as amended, are hereby amended to read as follows:

“Section 1013A.-Tax for Individuals, Estates, Corporations, Partnerships and Trusts Regarding Interest Paid or Credited on Bonds, Notes or Other Obligations of Certain Corporations or Partnerships and on Certain Mortgages.

(a) Tax Rate.-

(1) Special Tax Rate.- Any individual, estate, corporation, partnership or trust may avail itself of the option of paying, in lieu of any other taxes levied by this Subtitle, a tax equal to ten (10) percent on the total amount of non-exempt eligible interest paid or credited on bonds, notes or other obligations issued by a corporation or partnership described in clause (1) of subsection (b) *or* on mortgages constituted on residential property located in Puerto Rico described in clause (2) of said subsection.

(2) ...

(b) Definition of Eligible Interest.- For the purposes of this Section, the term ‘eligible interest’ means:

(1) Bonds, notes and other obligations.- Any interest on bonds, notes or other obligations issued by a domestic corporation or partnership or by a foreign corporation or partnership when not less than eighty (80) percent of its gross income derived during the three (3) year taxable period ending with the close of the tax year prior to the date of payment or crediting of the interest, constitutes income that is really related to the operation of an industry or business in Puerto Rico, including shares

in trusts that represent an interest on said bonds, notes or other obligations, provided that the product of said bond, note or other obligation is solely and exclusively used in the industry or business in Puerto Rico of said corporation or partnership, whether domestic or foreign, and/or its subsidiaries, within a period of not more than twenty-four (24) months as of the date of issue of said bond, note or other obligation.

(2) Mortgages on residential property located in Puerto Rico.-

(A) ...

(B) Any interest on mortgage loans on residential property located in Puerto Rico, whose interest are not exempt under Section 1022(b)(4) and shares in trusts that represent an interest on said loans (or any other instrument that represents an interest on said loans, provided the interest recipient is not a financial institute as said term is defined in Section 1024(f)(4).

(c) Requirements to opt for the provisions of this Section.-

(1) ...

(2) Exercising the option.-

(A) The option of paying only ten (10) percent of the tax referred to in clause (1) of subsection (a) is available to those eligible interest recipients that as of the date of acquiring the bond, note, other obligation or mortgage loan described in the preceding subsection (b), authorize the payer thereof to withhold the tax levied by said subsection (a). In such a case the individual, estate, corporation, partnership or trust shall not include in its gross income for the corresponding tax year, the income on account of eligible interest paid or credited on bonds, notes, other

obligations or mortgage loans described in the preceding subsection (b), as provided in Section 1022(b)(51).

Any individual, estate, corporation, partnership or trust that does not exercise the option provided herein shall be bound to include the income on account of interest paid or credited by any of said corporations, partnerships, financial institutions or mortgage loans as part of their gross income for the corresponding tax year, and pay the income tax based on the normal rates. The withholding agent shall make the withholding with regard to interest paid or credited as of the date on which the option is exercised pursuant to the procedures established in Section 1148 and shall be subject to the provisions thereof. This option, once exercised, shall continue in force until the interest recipient should opt otherwise.

(B) ...”

Article 2.-Clause (10) of subsection (a) of Section 1024 of Act No. 120 of October 31, 1994, as amended, is hereby amended to read as follows:

“Section 1024.-Non-deductible Items

(a) General Rule.-When calculating the net income in no case shall deductions be admitted with respect to:

(1) ...

(10) Interest paid on loans or other obligations whose amount has been directly or indirectly invested in deposits in savings accounts or certificates described in Section 1013, or in bonds, notes, other obligations or mortgage loans described in subsection (b) of Section 1013A, that are equivalent to the sum of the interest generated by the savings accounts or certificate, or by the bonds, notes, other obligations or mortgage loans described in subsection (b) of Section 1013A, on which it was elected

to opt for the tax rate of ten (10) percent provided in subsection (a) of said Section.”

Article 3.-A clause (51) is hereby added to subsection (b) of Section 1022 of Act No. 120 of October 31, 1994, as 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 exempt from taxation under this Subtitle:

(1) ...

(51) Eligible non-exempted interest paid or credited on bonds, notes, other obligations or mortgage loans described in subsection (b) of Section 1013A, which are subject to the special tax rate of ten (10) percent established in section 1013A.”

Article 4.-This Act shall take effect immediately after its approval.

CERTIFICATION

I hereby certify to the Secretary of State that the following Act No.48 (HB. 1300) of the 3rd Session of the 15th Legislature of Puerto Rico:

AN ACT amend clause (1) of subsection (a), amend clause (1) of subsection (b), add a paragraph (B) to clause (2) of subsection (b) and amend paragraph (A) of subsection (c) of Section 1013A; amend clause (10) of subsection (a) of Section 1024; and add a clause (51) to subsection (b) of Section 1022 of Act No. 120 of October 31, 1994, as amended, known as the “Puerto Rico Internal Revenue Code of 1994,” to clarify that the investment of the product of bonds, notes and other obligations whose interest is eligible under Section 1013A(b)(1) may be made in subsidiaries; include as part of the interest described in Section 1013A(b)(2) the shares in trusts that represent an interest in mortgage loans on residential property located in Puerto Rico whose interest is not exempt under Section 1022(b)(4); include the language of the amendment to Section 1022; and limit the deduction of expenses incurred in the interest on loans whose product is invested in obligations whose interest is eligible under Section 1013A(b) for the tax rate of ten (10) percent,

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

In San Juan, Puerto Rico, today 14th of August of 2006.

Francisco J. Domenech
Director