

Tax News

SAN JUAN, PUERTO RICO



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A Difference in Federal Taxes and Deductions



As a self-governing territory of the United States, Puerto Rico has a unique tax status. While residents of Puerto Rico are considered U.S. citizens, they are not subject to the same federal tax laws as citizens living in on the U.S. mainland.

Firstly, it is important to note that Puerto Rican citizens do not pay federal income tax on income earned in Puerto Rico. This means that if you are a resident of Puerto Rico and your income is solely derived from Puerto Rico sources, you will not have to pay federal income tax on that income.

However, Puerto Rican citizens are still subject to federal payroll taxes, which include Social Security and Medicare taxes. These taxes are paid by both the employee and the employer and are based on a percentage of the employee's wages. While these taxes are like those paid by U.S. citizens living in the 50 states, there are some differences in how they are calculated and administered.

Additionally, Puerto Rican citizens who earn income from sources outside of Puerto Rico are subject to federal income tax on

that income. This means that if you are a resident of Puerto Rico but earn income from investments or work outside of Puerto Rico, you will still have to pay federal income tax on that income.

Another important aspect to note is that Puerto Rican citizens are not eligible for some federal tax credits and deductions that are available to citizens living in the 50 states. For example, the Earned Income Tax Credit (EITC) and the Child Tax Credit are not available to Puerto Rican citizens. As we navigate the recent volatility in the



An Insight into Payroll Taxes for Puerto Rico

Businesses operating in Puerto Rico are still required to pay federal payroll taxes. In this article, we will explore the federal payroll taxes that Puerto Rican businesses must pay. Federal payroll taxes are a set of taxes that are paid by employers and employees on wages and salaries earned by employees. These taxes include Social Security tax, Medicare tax, and federal unemployment tax (FUTA). Employers are responsible for withholding these taxes from their employees' paychecks and remitting them to the federal government.

Social Security tax is a tax that provides

retirement, disability, and survivor benefits to eligible individuals. It is currently set at a rate of 6.2% for both employers and employees, with a wage base limit of \$147,000 for the year 2022. This means that employers in Puerto Rico must withhold 6.2% of their employees' wages up to the wage base limit and remit it to the federal government.

Medicare tax is a tax that provides medical insurance benefits to eligible individuals. It is currently set at a rate of 1.45% for both employers and employees, with no wage base limit. This means that employers in

Puerto Rico must withhold 1.45% of their employees' wages and remit it to the federal government.

FUTA is a tax that funds the federal unemployment program. It is currently set at a rate of 6% on the first \$7,000 of each employee's wages. However, Puerto Rican businesses may be eligible for a credit of up to 90% of their FUTA tax liability if they pay into the Puerto Rico unemployment program, known as the Unemployment Insurance Program (UIP).

Holding Real Property in a Corporation: Good or Bad Idea?



As the real estate market has cooled off in many parts of the country, investing in property may seem wise in the long run. But taxes can be a significant concern.

Owning real estate in a C corporation may not be wise when considering taxes because it puts you at risk of being double-taxed.

This means that if you sell the property and make a profit, the gain may be subject to taxation twice—once at the corporate level and again at the shareholder level when the corporation pays out profits to shareholders as dividends.

The Tax Cuts and Jobs Act reduced the double taxation threat, but with our current federal debt, you face the risk that lawmakers will hike the corporate tax rates and possibly also tax dividends at higher ordinary income rates.

To avoid this threat, I usually recommend using a single-member LLC or revocable trust to hold real property. A disregarded single-member LLC delivers super-simple tax treatment combined with corporation-like liability protection, while a revocable trust can avoid probate and save time and money.

If you are a co-owner of real property, it is advisable to set up a multi-member LLC to hold the property. The partnership taxation rules that multi-member LLCs follow have several advantages, including pass-through taxation.

In conclusion, holding real property in a C corporation can expose you to the risk of double taxation, and I don't recommend it. Instead, consider a single-member LLC, revocable trust, or multi-member LLC, depending on your situation.

Helicopter View of 2023 Meals and Entertainment

As you may already know, there have been some major changes to the business meal deduction for 2023 and beyond. The deduction for business meals has been reduced to 50 percent, a significant change from the previous 100 percent deduction for business meals in and from restaurants, which was applicable only for the years 2021 and 2022.

To help you better understand the current situation, see the table below:

Amount Deductible for Tax Year 2023 and Beyond

Description	100%	50%	Zero
Restaurant meals with clients and prospects		X	
Entertainment such as baseball and football games with clients and prospects			X
Employee meals for convenience of employer, served by in-house cafeteria		X	
Employee meals for required business meeting, purchased from a restaurant		X	
Meal served at chamber of commerce meeting held in a hotel meeting room		X	
Meal consumed in a fancy restaurant while in overnight business travel status		X	
Meals cooked by you in your hotel room kitchen while traveling away from home overnight		X	
Year-end party for employees and spouses	X		
Golf outing for employees and spouses	X		
Year-end party for customers			X
Meals made on premises for general public at marketing presentation	X		
Team-building recreational event for all employees	X		
Golf or theater outing or football game with your best customer			X
Meal with a prospective customer at a country club following your non-deductible round of golf		X	



Are You a Regular Investor or a Tax-Favored Securities Trader?

stock market, you may want to think about the possible favorable federal income tax treatment the tax code gives to a securities trader.

Suppose you can qualify as a securities trader for federal income tax purposes. In that case, you deduct your trading-related expenses on Schedule C of Form 1040 and make the taxpayer-friendly mark-to-market election, which is not available to garden-variety investors.

The mark-to-market election has two important federal income tax advantages:

1. Exemption from the capital loss deduction limitation
2. Exemption from the wash sale rule

But there is a price to pay for these tax advantages. As a trader who has made the mark-to-market election, you must pretend to sell your entire trading portfolio at market on the last trading day of the year,

which may have little or no tax impact if you have little or nothing in your trading portfolio at year-end.

Your trading activities must constitute a business for you to qualify as a securities trader, and you must meet both of the following requirements:

1. Your trading must be frequent and substantial.
2. You must seek to profit from short-term market swings rather than longer-term strategies.

If you are a calendar-year taxpayer, the deadline to make the mark-to-market election for your 2023 tax year is April 18, 2023 (that's right around the corner). You make the election by including a statement with your 2022 Form 1040 filed by that date or with a Form 4868 extension request for your 2022 return filed by that date.

Why Tax Deductions are Treated Differently

Puerto Rico is not treated the same as the 50 states when it comes to federal tax deductions. This has been a point of contention for many Puerto Rican citizens, who feel they are being treated unfairly. The following are some the reasons why Puerto Rico citizens don't qualify for the same federal tax deductions as their counterparts in the states.

The first reason is that Puerto Rico has its own tax system. Puerto Rico is treated as a separate tax jurisdiction from the United States, and its citizens are subject to Puerto Rican tax laws. While Puerto Rican tax rates are generally lower than those in the United States, the tax code is also more complicated. Puerto Rican citizens are not eligible for the same federal tax deductions as U.S. citizens because they are not paying U.S. federal taxes.

Another reason is that Puerto Rico is not considered a state. The U.S. tax code provides tax breaks and deductions for residents of the 50

states, but Puerto Rico is not one of them. This is since Puerto Rico is not a state but rather a territory of the United States. As a result, it is not entitled to the same tax benefits as the 50 states.

Additionally, Puerto Rico does not have representation in Congress. Puerto Rican citizens do not have voting representatives in Congress, which means they do not have a voice in the laws that are passed. This lack of representation has resulted in Puerto Rican citizens being excluded from many federal programs and benefits, including certain tax deductions.

Furthermore, the U.S. federal government does not provide as much financial assistance to Puerto Rico as it does to the states. This is since Puerto Rico is not considered a state, and therefore does not receive the same level of funding from the federal government. As a result, Puerto Rican citizens are not able to benefit from certain federal programs and tax deductions.

Avoid This Family-Member S Corporation Health Insurance Mistake

There are two important issues related to health insurance deductions for S corporations.

First, if you own more than 2 percent of an S corporation, there are three steps you need to follow to claim a deduction for health insurance:

- **Step 1.** The cost of the insurance must be on the S corporation's books.
- **Step 2.** The corporation must include the cost of the health insurance premiums on your W-2 form as taxable income (but not subject to payroll taxes).
- **Step 3.** If eligible, you must claim the health insurance deduction as an above-the-line deduction on Schedule 1 of Form 1040.

Second, this three-step procedure applies to your spouse, children, grandchildren, great-grandchildren, parents, grandparents, and

great-grandparents if they work for your S corporation and the corporation covers them with health insurance.

The three rules apply to the relatives listed above who work in the S corporation, even if they don't own any stock directly. For health insurance purposes, the tax code attributes your stock ownership to them and deems that they own what you own.

It's crucial to get this right, as failing to do so could result in a lost health insurance deduction for your family members and zero deductions for the S corporation.

If you or your S corporation did not handle this correctly in the past, you need to amend the returns to ensure that you create and protect the proper tax deductions.

