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# Why Does Puerto Rico Have Its Own Tax System?



Puerto Rico is a U.S. territory in the Caribbean that has a unique tax system different from that of the mainland United States. The reason behind this stems from Puerto Rico's political status as a territory, which grants the island certain autonomy in creating its own tax policies. In this article, we'll explore the historical and political factors that have shaped Puerto Rico's tax system and how it differs from that of the mainland.

## Puerto Rico's Political Status

Puerto Rico has been a U.S. territory since 1898, when the United States acquired the island from Spain as part of the Treaty of Paris that ended the Spanish-American War. Since then, Puerto Rico has been an unincorporated territory, meaning it is under U.S. jurisdiction but does not have the same rights and privileges as states. Residents of Puerto Rico are U.S. citizens by birth, but they cannot vote in presidential elections, have no voting representation in Congress, and are subject to different laws and regulations than those on the mainland.

## Tax Policy in Puerto Rico

One of the ways that Puerto Rico exercises its autonomy is through its tax policies. Unlike the mainland, which is subject to federal income tax laws, Puerto Rico has its own tax system. The Puerto Rican government has the power to levy its own taxes, set its own tax rates, and administer its own tax code.

One of the most significant differences between Puerto Rico's tax system and that of the mainland is that Puerto Rico does not collect federal income tax. However, residents of Puerto Rico are still subject to certain federal taxes, such as Social Security and Medicare taxes, which are paid by both employers and employees.

The tax system in Puerto Rico is structured around three main taxes: the sales and use tax, the individual income tax, and the corporate income tax. The sales and use tax is a 10.5% tax on most goods and services sold on the island. The individual income tax ranges from 0% to 33%, depending on income level, and is only applicable to income earned on the island. The corporate income tax is a flat rate of 37.5% for most businesses operating in Puerto Rico.

The history of Puerto Rico's tax system has been shaped by several factors. One of the biggest factors is the island's status as a U.S. territory. As a territory, Puerto Rico is not represented in Congress and has limited influence over federal policies that affect its economy. This has led to a push for greater autonomy in tax policy, as well as other areas such as trade and immigration.

Another factor is Puerto Rico's economic history. For much of the 20th century, Puerto Rico was heavily reliant on manufacturing and agriculture, but the island's economy has since shifted towards services and tourism. This has led to changes in the tax code to encourage investment and business growth on the island.

Puerto Rico's unique tax system can be attributed to its political status as a U.S. territory, which grants the island certain autonomy in creating its own tax policies. The tax system in Puerto Rico is structured around three main taxes: the sales and use tax, the individual income tax, and the corporate income tax. The history of Puerto Rico's tax system has been shaped by several factors, including the island's economic history and its push for greater autonomy in tax policy. Despite the differences between Puerto Rico's tax system and that of the mainland, the island remains an important part of the U.S. economy and a key player in the Caribbean region.



# 2023 Health Insurance for S Corporation Owners: An Update

Here's an update on the latest developments in 2023 health insurance for S corporation owners. As a more-than-2-percent S corporation owner, you are entitled to some good news when it comes to your health insurance.

To ensure that your health insurance deductions are in order, and to avoid the \$100-a-day penalties for violating the rules of the Affordable Care Act (ACA), you should take the following steps:

1. Get the cost of the health insurance on the S corporation's books, either by making the premium payments directly or through reimbursement.
2. Ensure that the S corporation includes the health insurance premiums on the

owner-employee's W-2 form, including the additional compensation in box 1 but not in boxes 3 or 5.

3. If you are an owner-employee with more than 2 percent ownership, claim the health insurance deduction as "self-employed health insurance" on line 17 of Schedule 1 of Form 1040. You must meet the two rules of not having access to employer-subsidized health insurance and having adequate salary.

For rank-and-file employees, the S corporation does not have to provide health insurance benefits, but if it does, it must use an acceptable ACA plan, such as (among others) the qualified small employer health reimbursement arrangement (QSEHRA) or the individual coverage HRA (ICHRA).

The S corporation can reimburse more-than-2-percent owners for individually purchased insurance without any penalties, but if it reimburses rank-and-file employees without using the QSEHRA or ICHRA, it faces the \$100-a-day penalty per employee.

If you are looking to provide health benefits to employees through the S corporation, there are many tax-advantaged options available. If the S corporation provides group health insurance to all employees, including the shareholder-employee, the same rules apply.



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# Tourism Business Thrives in Puerto Rico

Tourism businesses in Puerto Rico have long thrived due to a combination of factors, including the island's natural beauty, rich culture, and strategic location. Let's explore why these tourism businesses do so well:

## 1. Beautiful Beaches and Scenery

One of the primary reasons why tourism businesses do well in Puerto Rico is due to the island's stunning natural scenery. With over 270 miles of coastline, Puerto Rico has some of the most beautiful beaches in the Caribbean, such as Flamenco Beach on the island of Culebra and Playa Sucia in Cabo Rojo. Visitors can also enjoy the island's lush rainforests, towering mountains, and crystal-clear rivers, making Puerto Rico an ideal destination for nature enthusiasts.

## 2. Rich History and Culture

Puerto Rico has a rich history and culture that attracts visitors from around the world. The island's heritage is a unique blend of Spanish, African, and indigenous Taíno cultures, which is reflected in its music, art, and architecture. Visitors can explore historic sites such as the forts of Old San Juan or the ancient Taíno ceremonial center at Tibes or attend cultural festivals such as the San Sebastián Street Festival or the Casals Festival.

## 3. Strategic Location

Puerto Rico's strategic location in the Caribbean has also contributed to the success of tourism businesses on the island. Located between the Eastern Caribbean and the United States, Puerto Rico is easily accessible for visitors from both regions. The island is also a popular stop for cruise ships and has a modern airport with direct flights to major cities in the United States, Europe, and Latin America.

## 4. Diverse Tourism Offerings

Puerto Rico offers a wide variety of tourism offerings, catering to a range of interests and budgets. Visitors can choose from luxury resorts, boutique hotels, eco-lodges, and vacation rentals, depending on their preferences. The island also offers a range of activities, such as surfing, snorkeling, hiking, and golfing, ensuring that there is something for everyone.

## 5. Supportive Tourism Infrastructure

Finally, tourism businesses in Puerto Rico have been able to succeed due to a supportive tourism infrastructure on the island. The Puerto Rico Tourism Company, a government agency responsible for promoting tourism, provides incentives and support to businesses in the sector. Additionally, the island has a skilled workforce, excellent transportation infrastructure, and a robust network of tourism-related businesses such as tour operators, transportation providers, and food and beverage establishments.

# SECURE ACT 2.0

## CREATES NEW TAX STRATEGIES FOR RMDs

**As you are likely aware, if you have an IRA or other tax-deferred retirement account, you must start taking required minimum distributions (RMDs) once you reach a certain age.**

The SECURE 2.0 Act raises the age at which RMDs must first be taken, from age 72 to age 75, over the next 10 years. Specifically, the RMD age will be 73 for those born between 1951 and 1959 and 75 for those born in 1960 or later.

The purpose of RMDs is to ensure that you use the funds in your retirement accounts while you are still alive, rather than using those accounts as an estate planning device to pass money to your heirs tax-free.

The amount you are required to withdraw as an RMD depends on your age and the balance of your retirement account as of December 31 of the previous year. RMDs are required for traditional IRAs; SEP-IRAs; SIMPLE IRAs; solo 401(k) plans; and all employer-sponsored tax-deferred retirement plans, including 401(k) plans, 403(b) plans, profit-sharing plans, and 457(b) plans.

Your first RMD must be taken by April 1 of the year following the year you reach the age of RMD. For example, if you turn 73 in 2024, you have until April 1, 2025, to take your first taxable RMD. And then, including in 2025 and every year thereafter, you must take an annual RMD on or before December 31.

It's important to note that taking two RMDs in one year could increase your tax bracket and even your Medicare premiums. If you are faced with this situation, it's best to take the first RMD in the year you reach the age of RMD.

In the past, the IRS imposed an "excess accumulation" penalty tax of 50 percent if you failed to take your full RMD by the deadline. But starting in 2023, the SECURE 2.0 Act reduces the penalty to 25 percent. If you correct the shortfall within the "correction window," you can reduce the penalty to 10 percent. The correction window begins on January 1 of the year following the RMD shortfall and ends on the earlier of

- when the IRS mails a Notice of Deficiency,
- when the penalty is assessed, or
- the last day of the second tax year after the penalty is imposed.

If the shortfall was due to reasonable error and you took reasonable steps to remedy it, you may request a penalty waiver by filing IRS Form 5329 and a letter explaining the reasonable error. Before filing the waiver request, you should make a catch-up distribution from your retirement accounts to make up for the RMD shortfall.

# Plan Your Passive Activity Losses for Tax-Deduction Relevance



In 1986, lawmakers drove a stake through the heart of your rental property tax deductions.

That stake, called the passive-loss rules, causes myriad complications that now, 37 years later, are still commonly misunderstood.

## THE TRAP

In 1986, lawmakers made you shovel your taxable activities into three basic tax buckets. Looking at the buckets from a business perspective, you find the following:

1. Portfolio bucket for your stocks and bonds
2. Active business bucket for your material participation business activities
3. Passive-loss bucket for your rentals plus other activities in which you do not materially participate

This letter explains three escapes from the passive-loss trap so that you can realize the tax benefits from your rental losses.

### Escape 1: Get Out of Jail Free

Lawmakers allow taxpayers with a modified adjusted gross income of \$100,000 or less to deduct up to \$25,000 of rental property losses. Once your income goes above \$100,000, the get-out-of-jail-free loss deduction drops by 50 cents on the dollar and disappears altogether at \$150,000 of modified adjusted gross income.

### Escape 2: Changes in Operations

If you, or you and your spouse, have modified adjusted gross income that exceeds the threshold, you need a different plan to obtain immediate benefit from your rental property tax losses.

To begin, let's review how the tax-benefit dollars get trapped in the first place. As you may remember, to benefit from your rental property tax loss, you must either

1. have passive income from other properties or another source, or
2. both qualify as a real estate professional and materially participate in the rental property.

**Example.** Say the taxable income on your Form 1040 is \$200,000 and you have one rental property. Say further that rental has produced a tax loss of \$10,000 a year for the past six years, none of which you have been able to deduct because you have no other passive income and you do not qualify as a tax-law-defined real estate professional.

So here you sit: \$60,000 in tax deductions trapped in the passive-loss bucket—not available for deduction against the income from the other buckets.

### Not Lost, Just Waiting

This is sad, no doubt, but there's some good news even in this bucket as you now see it. The \$60,000 is not going to drown, disappear, or lose its tax-deduction attributes in some other way. That \$60,000 simply waits in the bucket for you to give it an escape route.

Here are four possibilities for the escape route:

1. Generate passive income.
2. Change the character of the rental to non-passive.
3. Change your status to that of a real estate professional and pass the material participation test for this property.
4. Sell the property, as explained in Escape 3 below.

### Escape 3: Total Release

The \$60,000 that's trapped in the passive-loss bucket is like money in the bank. You can tap the trap when you want to release the deductions. It's really quite easy.

Here we are talking about releasing the entire \$60,000 at once (a major jailbreak). You might want to do this right now, or you can wait. You have many options, and the good news is that you are the one in charge of this total release of your passive losses.

To release the losses, you need to make a complete disposition. For example, say you sell 100 percent of the property to a third party. Presto! You now deduct the entire \$60,000 in trapped passive losses.

### Takeaway

The one thing to know is that if you have rental property losses that are trapped by the passive-loss rules, you have some strategies available.

# Biomes of Puerto Rico

As an archipelago in the northeastern Caribbean, Puerto Rico is a tropical paradise with a diverse landscape and a wide range of biomes. The island's terrain is characterized by rugged mountain ranges, lush rainforests, and stunning beaches, making it a popular destination for tourists and nature enthusiasts alike.

## Tropical Rainforest Biome

The tropical rainforest biome covers much of Puerto Rico's interior and is home to a wide variety of plant and animal species. The El Yunque National Forest, located in the northeast part of the island, is the only tropical rainforest in the U.S. National Forest System. It is home to over 200 species of trees, including the giant kapok tree, as well as a variety of animal species, such as the coqui frog and the Puerto Rican parrot. The rainforest is also known for its numerous waterfalls, including La Mina Falls, which cascades over 35 feet into a crystal-clear pool.

## Dry Forest Biome

The dry forest biome is found in the southwestern part of Puerto Rico and is characterized by arid conditions and sparse vegetation. The Guánica Dry Forest Reserve, a UNESCO Biosphere Reserve, is home to several endemic plant and animal species. The reserve is also home to several caves and caverns, including the Las Palmas Cave, which is over 3 miles long and features a unique subterranean ecosystem.

## Mangrove Biome

The mangrove biome is found in the coastal areas of Puerto Rico and is characterized by shallow, brackish waters and a unique mix of plant and animal species. The Jobos Bay National Estuarine Research Reserve, located in the southeastern part of the island, is one of the largest mangrove ecosystems in Puerto Rico. The reserve is home to several rare and endangered species, including the West Indian manatee and the green sea turtle.

## Coastal Biome

The coastal biome is found along Puerto Rico's 300 miles of coastline and is characterized by sandy beaches, rocky cliffs, and coral reefs. The island's beaches, such as Flamenco Beach on the island of Culebra and Luquillo Beach on the mainland, are popular destinations for tourists and locals alike. The coral reefs surrounding the island are home to a wide variety of marine life, including colorful fish, sea turtles, and rays.

## Mountain Biome

The mountain biome is found in the central part of Puerto Rico and is characterized by rugged peaks and steep slopes. The Cordillera Central Mountain range, which runs through the middle of the island, is the highest mountain range in Puerto Rico, with peaks over 4,000 feet tall. The mountains are home to a few endemic species, including the Puerto Rican boa and the Puerto Rican sharp-shinned hawk.



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