

Informative Booklet

**To Provide Orientation about your Income
Tax Return**

In this informative booklet, the Department of the Treasury has compiled the most common questions asked by our taxpayers when filing their Income Tax Return to inform and facilitate the process of fulfilling their fiscal responsibility.

Remember that the Income Tax Return can be delivered at any of the Internal Revenue Collection Offices or can be send by mail.

For additional information or to clarify any doubts, do not hesitate to call (787) 721-2000 extension 3611 or (1) (800) 981-9236. In addition, you can access our site on the Internet at <http://www.hacienda.gobierno.pr>

1. Who must file an income tax return in Puerto Rico?

Puerto Rico resident individuals whose gross income from all sources exceeds the following amounts:

Married filing jointly	\$6,000
Single or married not living with spouse	\$3,300
Married filing separately	\$1,500

Nonresident U.S. citizens whose gross income from sources within Puerto Rico has not been subject to withholding of tax at source, provided such income exceeds the following amounts:

Married filing jointly	\$3,000
Single or married not living with spouse	\$1,300
Married filing separately	\$1,500

Nonresident alien individuals who received gross income from sources within Puerto Rico during the taxable year, unless the tax imposed over such income has been fully withheld at source.

2. Who must file the Short Form?

The Short Form must be filed by those taxpayers meeting all the following requirements:

- a. whose gross income is less than \$75,000;
- b. whose income consists exclusively of salaries and wages subject to Puerto Rico income tax withholding, salaries and wages from the Federal Government, or payments from annuities and pensions;
- c. who has not received income in the form of alimony, interest, dividends, sole proprietorship business or other income;
- d. who do not claim a deduction for alimony paid;
- e. who are claiming the standard deduction;
- f. who are not claiming a credit for foreign taxes paid;
- g. who are only claiming credits for salaried taxpayers, credit for salaried persons or pensioners, or the credit for contributions to the Educational Foundation for Free Selection of Schools;
- h. who are not required to file an Estimated Tax Declaration;

- i. who are U.S. citizens or resident aliens, who do not participate in Major League Baseball games or U.S. National Basketball Association games celebrated in Puerto Rico;
- j. who are not filing under the status of married filing separate returns; and
- k. who are not claiming a credit for withholding of income tax at source for services rendered.

All other taxpayers must file the Long Form.

3. If I got married during the year, how must I file the return?

The taxpayer's personal status is determined at the end of the taxable year. Therefore, you must file a return as married living with spouse and include both incomes. However, you can file separate returns. In this case, each spouse must report income and deductions separately.

4. If I do not qualify to file the Short Form, can I claim the standard deduction?

Yes. You can file the Long Form and also claim the standard deduction. In this case, you cannot claim as a deduction those items that constitute itemized deductions.

5. Is it true that married persons living with spouse can file separate returns?

Yes. The Puerto Rico Internal Revenue Code of 1994, as amended (Code) provides that those individuals that at the end of the year are married and living together can file separate returns. However, both spouses must file the same type of return and use the tax table provided to determine their tax liability under this option.

6. I am divorced. Is the amount paid for child support deductible in my income tax return?

No. The amount paid for child support is not deductible in the payer's income tax return.

7. Can I deduct alimony payments made to my ex-wife?

Yes, as long as the payment is made to a former spouse, the payer and the former spouse are not members of the same household, and there is no obligation to make such payments after the death of

the spouse receiving it. You must keep for your records a copy of the divorce decree, evidence of payments and the former spouse's social security number.

The spouse receiving the alimony payment must include it as income in the return.

8. I am divorced. My ex-wife and I provided more than 50% of our children's support and she has their custody. Who can claim the dependent exemption?

When parents provide more than 50% of their children support, the exemption for dependents will be claimed by the parent who has the custody of the child. However, the custodial parent can release the right to claim the exemption to the non-custodial parent. This release must be made in writing by completing Schedule CH Individual (Release of Claim to Exemption for Child (Children) of Divorced or Separated Parents). The non-custodial parent must submit such schedule with the return.

9. My two sons who are under 21 years work in part-time jobs, but only one of them is a full time student. Can I claim them as dependents in my income tax return?

The son who works and is not a regular student can be claimed as a dependent if his gross income for the taxable year does not exceed \$1,600. The other son who works and is a regular student can be claimed as a dependent if his gross income for the taxable year does not exceed \$3,400.

10. My son is a college student outside of Puerto Rico. Can I claim him as a dependent?

Yes, as long as your son has completed at least one school semester as a regular student and the university is recognized as such by the educational authorities of Puerto Rico or of the corresponding country. He must be under 26 years of age during the taxable year and his gross income cannot exceed \$3,400.

11. Is it true that the exemption for college student applies to those students attending professional-technical post-secondary institutions recognized by educational authorities?

Yes, provided that the student has completed at least one semester as a regular student, is under 26 years of age during the taxable year, and has not earned income over \$3,400 during the taxable year.

12. My father receives social security, can I claim him as a dependent?

Social security income is not taxable in Puerto Rico. For that reason, if your father is not required to file an income tax return, and you provided over 50% of his support, you can claim him as a dependent in your income tax return.

13. During this year I have provided more than 50% of my father's support even though he does not live in Puerto Rico. Can I claim him as a dependent in my return?

If your father does not live in Puerto Rico, but he is a U.S. citizen, you can claim him as a dependent if you provided over 50% of his support during the taxable year and your father's gross income does not exceed \$1,600. **However, if your father is a Puerto Rico nonresident alien you cannot claim him as a dependent.**

14. Is it necessary to submit the social security number of each dependent claimed in my return?

Every taxpayer must indicate in the return the social security number of any dependent claimed who is one year or older at the end of the taxable year. If not provided, the dependent exemption will not be allowed.

15. What is the Optional Standard Deduction?

This deduction is a fixed amount that the Code provides as an alternative to the itemized deductions. The amount of the optional standard deduction varies according to your filing status:

- | | |
|---|---------|
| a. Married living with spouse and filing jointly | \$3,150 |
| b. Single or married not living with spouse | \$2,100 |
| c. Head of household | \$2,730 |
| d. Married living with spouse and filing separately | \$1,575 |

16. The additional deductions can be claimed in the Short Form or the Long Form. Which are these deductions?

The additional deductions are the following:

- a. contributions to an Individual Retirement Account (IRA);
- b. contributions to governmental pension or retirement systems;

- c. deduction when both spouses work, receive earned income and file a joint return;
- d. veterans deduction;
- e. ordinary and necessary expenses;
- f. automobile loan interest;
- g. young people who work;
- h. contributions to an Educational Contribution Account; and
- i. expenses incurred for the acquisition and installation of a personal computer used by dependents.

You can claim these deductions in addition to the optional standard deduction or the itemized deductions.

17. To claim the allowable deductions, is it necessary to submit any evidence?

No. You do not have to include with the return the evidence to support any additional or itemized deductions. However, you must keep such evidence for at least 6 years, in case that they may be required as part of an investigation or audit procedure. In such cases, if you do not submit the evidence, your return will be adjusted and additional taxes, including interest and surcharges will be assessed.

18. Is it true that I can claim on the return a deduction for the telephone service payment for communication with military personnel in combat zone?

Yes. You can claim up to a maximum of \$200 for the expense incurred in the telephone communication with your spouse, brother (sister), son (daughter), grandchild, parent, or grandparent who is in active service as military personnel in combat zone.

In order to claim this deduction, including the military personnel, you must submit with the return your telephone calls registry, originated from your telephone number or originated from the telephone number where the military personnel is located and the same is charged to your telephone number.

When the call is originated in Puerto Rico from a telephone number other than the one corresponding to the person claiming this

deduction, or in the absence of telephone service of your own, said person, along with the person in the name of which the telephone calls registry appears, must present a joint sworn statement stating the payment of the telephone calls made by the person claiming the deduction and the receipt of such payment by the other person.

For purposes of this deduction, military personnel includes the members of the United States Armed Forces, as well as the members of the Puerto Rico National Guard who are activated during the period of the conflict and serve in the combat zone. On the other hand, combat zone means the area designated through Executive Order from the President of the United States as the area in which the United States Armed Forces will combat during the period of the conflict.

19. Is any amount exempt from my Puerto Rico Government Retirement System pension?

The first \$8,000 from all pensions granted by the Puerto Rico Government, the United States Government or by any instrumentalities or political subdivisions of both governments, are excluded from gross income if the pensioner is under 60 years. For pensioners 60 years of age or older, the exclusion is \$12,000. If the taxpayer receives more than one annuity or pension, the exclusion will apply separately to each annuity or pension. After claiming this exclusion, the rule that allows the recovery of the cost of the annuity or pension exempt of income tax will be applied. To claim this exclusion you must complete and file Schedule H Individual.

20. I am receiving a private business retirement pension. Is there any exemption for such pension?

Yes. You can exclude the first \$8,000 if you are under 60 years of age or \$12,000 if you are 60 years of age or older. After claiming this exclusion, the rule that allows the recovery of the cost of the annuity or pension exempt of income tax will be applied.

21. Is it true that upon retirement from the public service my contributions to the Retirement System are taxable?

Contributions (cost of pension or annuity) made by public employees to the Retirement System of the Government of Puerto Rico are not taxable once you start receiving them. However, interest earned on those contributions is taxable.

22. I am married filing jointly. Can I deduct up to \$10,000 in my return for contributions made to an Individual Retirement Account (IRA)?

Yes. In the case of married persons filing jointly, the deduction for contributions made to an IRA cannot exceed the lesser of \$10,000 or the aggregated adjusted gross income from salaries or earned income attributable to a profession or business. To claim the maximum contribution, you must open an IRA of \$5,000 for each spouse.

If you only receive income from annuities or pensions, you cannot claim the contribution made to an IRA.

23. I am married filing jointly. My spouse and I both work. Is it true that there is a special deduction for us?

Yes. If both spouses work and file their return under the filing status of married living with spouse filing jointly, they are entitled to claim as an additional deduction, the amount of \$3,000.

24. I understand that there are some limitations regarding the ordinary and necessary expenses in the case of employees. Which are they?

The deduction for ordinary and necessary expenses, related to the exercise of a profession or occupation as employee that have not been reimbursed by the employer, is limited to the lesser of the amount paid, \$1,500 or 3% of the adjusted gross income from salaries.

25. I wear a uniform in my job as a secretary of a company. Can I claim as part of my ordinary and necessary expenses the cost and maintenance of such uniform?

In order to claim a deduction for the use of uniforms, it is required to comply with the following:

- a. the uniform must be of a specific kind required as a job condition, such as in the case of policemen, firemen and nurses; and
- b. it cannot be used in substitution of the general use clothing.

26. Is it true that I can deduct the interest expense from an automobile loan?

Yes, you can deduct up to \$1,200 of the amount of interest paid or accrued on a loan for the acquisition of an automobile. The deduction is allowed for only one automobile per taxpayer.

27. I have a car under a leasing contract. Can I claim as a deduction the interest paid?

Yes, provided the leasing contract is one with a purchase option. This deduction is limited to \$1,200.

28. I am a college student who works. Am I entitled to a special deduction?

Yes. An additional deduction of \$1,000 is allowed if at any time during the taxable year, you are between 16 and 25 years old and work.

29. What is an Educational Contribution Account?

In general, it is a trust created or organized under the laws of the Commonwealth of Puerto Rico by an individual for the exclusive benefit of his children or relatives up to the third degree of consanguinity or second of affinity. It can be established only by the person who has the custody and the rights and obligations conferred by law to the beneficiary. This trust must comply with the investment requirements provided under Section 1169(a)(3) of the Code.

The total balance of the trust should be distributed to the beneficiary for the purpose of paying the cost of post-secondary education, after having graduated from high school and not later than the taxable year in which he attains 30 years of age.

30. In addition to saving money for educational expenses, what other benefit may I obtain by establishing an Educational Contribution Account?

You are entitled to an additional deduction that cannot exceed \$500 for each beneficiary for which you made the contributions. There is no limitation as to the number of educational contribution accounts to which each individual can contribute, as long as such beneficiary is eligible. This deduction will not be allowed for a taxable year in which the beneficiary has attained 26 years of age.

31. Is there a due date to make the contributions?

Yes. In order to claim this additional deduction, you must contribute to the Educational Contribution Account no later than the last day provided by the Code to file your income tax return, including any extension of time granted by the Secretary.

32. Is it true that I can deduct the expenses incurred in the acquisition and installation of a personal computer to be used by my dependents?

Yes, it is true. You can deduct up to \$500, if you incurred in expenses for the acquisition and installation of a personal computer in your home to be used by your dependents, as long as they have not reached the age of 21 and receive from you more than half of their support. A taxpayer can claim only one deduction for this purpose.

33. In addition to my principal residence located in San Juan, I have a second residence in Ponce. Can I claim the mortgage interest of both residences?

Yes. You may deduct the mortgage interest paid on your principal and second residence. However, to claim the deduction for the second residence, it must have been used by you or any member of your family as a residence for a number of days that exceeds the greater of:

- 14 days; or
- 10% of the number of days during the taxable year in which the property was rented at the rental value prevailing in the market.

34. Are the financing charges of my home mortgage loan deductible? Where can I claim them in the return?

The financing charges known as loan origination fees and loan discounts financed through a home mortgage loan to acquire the principal residence are deductible during the term of the loan. If all financing charges were paid during the same taxable year, you can claim the total amount in such year.

It is important that in both situations you keep for your records the Uniform Settlement Statement or the Informative Return – Mortgage Interest (Form 480.7A). The amount determined as financing charges should be claimed on Schedule A Individual (Itemized and Additional Deductions), Part 1, Line 1 of the Long Form.

35. Is it true that the interest paid on my personal loan for home improvements is deductible as mortgage interest?

Yes, provided that you used the proceeds of the loan to acquire, build or improve a qualified residence, when such residence is not accepted by the financial institution as a mortgage guarantee (i.e., wood residence). You must keep for your records copy of the property tax exemption application or the revised appraisal of the property.

36. I own a house in the United States, which is my principal residence. Can I claim as a deduction the property tax paid?

Yes, as long as such residence constitutes your principal residence and subject to certain limitations imposed by the Code. Property tax paid on a second residence is not deductible.

37. I live in a rented house. Can I claim the rent payments?

Yes. You can claim as a deduction the lesser of 10% of the total rent paid during the taxable year or \$500. In order to claim this deduction, you must indicate the social security number of the person to whom the payment was made. In the case of a married person filing separately, you can claim the lesser of \$250 or 10% of the total rent paid.

38. Can I claim the loss of property resulting from a hurricane?

The Code provides certain deductions that you can claim in your return for loss of property resulting from casualties, such as a hurricane. This deduction is allowed for:

a. Loss on the principal residence resulting from fire, hurricane or other casualty.

If you had a loss on the real property, which constitutes your principal residence, you can claim as a deduction the amount not compensated by insurance or otherwise in the year of such loss. You must keep for your records the following documents:

1. copy of the Civil Defense Certification describing the type of damage; and
2. any document, public deed or appraisal, which reflects the value of the property.

b. Loss of personal property as a result of certain casualties.

If you had a loss of personal property such as automobiles, furniture and household goods (excluding the value of jewelry or cash), you can claim a deduction for the amount not compensated by insurance or otherwise up to \$5,000. The portion of the \$5,000 amount not used during the taxable year in which the loss occurred, may be carried over to the following two taxable years. In order to be entitled to claim this deduction:

1. the affected area must be declared as a disaster area by the Governor of Puerto Rico;
2. the taxpayer must request the benefits available from the assistance programs qualified by state or federal agencies; and
3. the taxpayer must keep a copy of the claim filed describing the damages sustained approved by any of the assistance programs qualified by state or federal agencies.

39. Which amount can I claim for childcare expenses?

You can claim as an itemized deduction up to a maximum of \$1,200 for one dependent or \$2,400 for two or more dependents. You must keep for your records receipts or cancelled or substitute checks.

Remember that this deduction is allowed only for children under 14 years of age.

40. Is it true that I can claim on my return a deduction for expenses incurred in the care of elderly persons?

Yes. You can claim as part of the itemized deductions up to a maximum of \$600 for the care of one elderly person (or \$1,200 for two or more elderly persons) who is your dependent. You must keep for your records receipts or cancelled or substitute checks to support the payment made.

Remember that the person with respect to whom this deduction is claimed must have reached the age of 60, within the taxable year in which the deduction is claimed for the first time.

41. Can I claim as a deduction for medical expenses amounts paid to a nursing home for my mother?

No, these expenses are not deductible. The deduction allowable for medical expenses includes amounts paid for diagnose, healing, treatment or prevention of diseases. It also includes amounts paid for an accident or health insurance and any applicable deductibles.

42. In my community we are collecting funds to pay the medical expenses of a neighbor. Can I claim as a charitable contribution my contribution to that fund?

No. Only charitable contributions made to nonprofit organizations qualified by the Department of the Treasury are deductible.

43. To which organizations may I contribute in order to claim such contributions as a deduction in my income tax return?

You can claim as charitable contributions, subject to certain limitations, the contributions made to the Commonwealth of Puerto Rico or to the United States Government. Also, you may deduct the contributions made during the year to religious, charitable, scientific, literary or educational organizations, or to organizations for the prevention of cruelty to children or animals, or to organizations of war veterans in the United States or Puerto Rico. The deduction will be allowed only if no part of the net earnings of any organization to which you contribute, may benefit any private shareholder or individual, and if the organization has been qualified as a non profit organization by the Department of the Treasury.

44. Once contributions to any of the qualified organizations are made, which amount can I claim as a deduction for charitable contributions?

The allowable deduction is the greater of: the total amount of contributions paid that exceed 3% of your adjusted gross income, or 33% of the contributions paid during the taxable year. However, the deduction allowed shall not exceed 15% of your adjusted gross income, except that an additional deduction of up to 15% of your adjusted gross income is allowed for contributions to accredited educational institutions of a university level established in Puerto Rico, to the José Jaime Pierluisi Foundation, to the National Fund for the Financing of Cultural Affairs of Puerto Rico, to the Puerto Rico Communitarian Foundation, for contributions of conservation easements to government agencies or non profit organizations, as well as for contributions to museological institutions, private or public, that consist of art work properly appraised or of any other objects of recognized museological value.

45. What is the maximum amount deductible for dependent's educational expenses?

You can deduct up to \$300 (\$150 if married filing separately) for each dependent enrolled at an elementary school level, from pre-kindergarten to sixth grade, or \$400 (\$200 if married filing separately) for each dependent at secondary school level up to the twelfth grade, or the amount actually paid, whichever is lesser.

46. I am a college student and I own a business. Can I deduct the interest paid on a student's loan?

Interest paid on students loans to cover expenses of the taxpayer for registration, tuition and text books at university level, as well as expenses for transportation, meals and lodging in those cases in which the taxpayer had to live outside his home in order to pursue such studies, are deductible as part of the itemized deductions. This deduction must be claimed on Schedule A Individual, Part I, line 15 of the Long Form. You cannot deduct this amount as part of the operating expenses of your business.

47. Is it true that the income received for services rendered in Puerto Rico to a Major League baseball team or the U.S. National Basketball Association is subject to a special tax?

Yes. The income received by an individual resident or non resident of Puerto Rico paid by a Major League baseball team or the U.S. National Basketball Association for games celebrated in Puerto Rico, is subject to a 20% withholding of tax at source.

The income received must be informed on Schedule F Individual, Part VI, line 1, Column D and the tax withheld on Schedule B Individual, Part III, line 17.

48. I am self-employed and income tax was withheld from the payments I received for services rendered. Can I claim this withholding as a credit when I file the income tax return?

Yes. Amounts withheld will be credited against the income tax determined in your return for the calendar year. In order to claim this withholding, you must include Form 480.6B with your return. For additional information about this withholding refer to the Informative Booklet Regarding the Withholding at Source in Case of Services Rendered.

49. Can I claim the contributions made to the Educational Foundation for Free Selection of Schools?

Yes. Every resident individual can claim as a credit the contributions made to such foundation. The amount of the credit allowed cannot exceed \$250. Contributions made in excess of the credit amount will be allowed as a deduction for charitable contributions, up to the limit allowed by the Code.

Remember that you can claim the contributions made until April 15 or until the due date of any extension of time granted to file the income tax return.

50. How can I claim on my return the contributions made to the Santa Catalina Palace Patronage?

The contributions made to the Santa Catalina's Palace Patronage (Patronage) generate a tax credit instead of a deduction for charitable contributions. This credit is equivalent to 50% of the contributions made. The same must be claimed on Schedule B Individual, Part II, line 15 of the Long Form.

In order to be entitled to this tax credit, you must include with your return the certification issued by the Patronage indicating that the contribution was made and that it was accepted.

51. When is an amended return filed?

An amended return is filed when you omit some income or when you do not claim a deduction, exemption or credit you were entitled to, or when you claimed a deduction, exemption or credit in your original return to which you were not entitled to.

If the amended return results in a refund or additional credit, it must be filed within 4 years from the date the original return was filed, as long as the original return was filed on time. If the original return was filed late, you will only have 3 years, from the date the original return was supposed to be filed, to amend the return and claim a refund or additional credit.

In order to process an amended return you must use an income tax return form corresponding to the taxable year that you are going to amend, and check the amended return box, which is located in the upper right corner of the return.

- 52. I am a Puerto Rico resident and I received dividends from investments in foreign corporations that are not engaged in trade or business in Puerto Rico. Are these dividends subject to the 10% special tax?**

No, because the dividends are from a corporation that is not engaged in trade or business in Puerto Rico. This income must be informed as ordinary income and will be subject to the regular tax rates.

- 53. My husband died during the year. How must I file my return?**

You have to file a return under your husband's name, including income received, from January 1st to the date your spouse died, and claim the personal exemption of married living with spouse. You will file another return for the period comprehended between the date of your spouse's death through the end of the taxable year, including the income generated during such period and claiming the personal exemption that you are entitled to at the end of the taxable year.

- 54. Which of my dependents gives me the right to qualify for head of household status?**

In order to claim head of household status, the dependent must live with you and you must provide more than 50% of his support during the taxable year. This dependent must be closely related to the taxpayer either by blood, marriage or adoption. **A dependent, who makes you qualify as a head of household, cannot be included in the computation of the total exemption for dependents.**

A married individual living with his spouse is not a head of household for tax purposes; therefore, he should not include the wife's name in the box of head of household.

- 55. I am a retailer and my principal industry is a drugstore. During the year I had a loss. My wife income is from salaries. Can I claim such loss against my wife's salary?**

No. The loss of your industry or principal business can only be claimed against the income from sources other than salaries or pensions. Notwithstanding, if you were a salaried employee and also engaged in any trade or business as your principal activity, and had a loss in that year, you may deduct such loss from your or your spouse's salaries and wages only in the first year in which you began the business and in the following two years. This is a once in lifetime benefit.

- 56. I was a salaried employee until June 2005 and in July I established a business. At the end of the year I had a loss. Can I claim the same as a deduction against my salary?**

Yes, you can claim the loss as a deduction against your salary and your wife's salary, since it is the first year of your business. The loss can be claimed on the first year it is incurred and carried over to the following two years. This benefit is granted only once in lifetime.

- 57. We are a married couple and each one has a principal business. In one of the businesses we had a loss. Can we claim such loss against the gain, if any, of the other principal business?**

Yes. Losses incurred in your or your spouse's principal business or industry, can be claimed against income from other sources that are not salaries and pensions.

- 58. Are meals and entertainment expenses deductible?**

Yes, meals and entertainment expenses are deductible, as long as they are neither luxurious nor extravagant, if incurred while you are absent of your residence and have not been reimbursed by your employer. Nevertheless, this deduction is limited to 50% of the total expenses incurred, up to 25% of your gross income, in the case of self-employed individuals.

- 59. If a dependent dies in January 2005, can I claim him as a dependent when filing the return for 2005?**

Yes, you can claim the exemption for a dependent that is born or has died during the taxable year. An example of this situation is when the dependent is born in December 2004 and dies in January 2005, in which case, you can claim the full exemption for dependent in both taxable years.

- 60. I am receiving my IRA distribution as an annuity. Can I claim the exclusion of \$8,000 or \$12,000?**

No. Such exclusion applies only to those annuities granted by the Commonwealth of Puerto Rico, the Government of the United States or by private employers.

- 61. I made a withdrawal from my IRA before age 60 and a 10% penalty was withheld. Can I claim such penalty as a deduction?**

No, this penalty is not deductible. However, it is part of the distribution so you have to include it as income on the year received.

- 62. Is it true that I can withdraw my contributions to an IRA for the acquisition of a computer without the 10% penalty?**

Yes. You may withdraw up to a maximum of \$1,200 for the acquisition or purchase of a computer for the use of a dependent who is within the second degree of consanguinity and who is enrolled at an educational institution up to a university level. Such withdrawals can only be made once every 6 years.

Remember that once you withdraw the funds, they must be informed as part of your taxable income on Schedule F Individual.

- 63. I make contributions to the qualified retirement plan sponsored by the company I work with. Can I also make contributions to an IRA?**

Yes. The maximum limit of the contributions to an IRA cannot exceed the difference, if any, between the contributions made to a cash or deferred arrangement (401K Plan) and the maximum amount allowable as a contribution to the plan.

- 64. I am a pensioner of the Retirement System of the Employees of the Commonwealth of Puerto Rico and will soon receive my IRA distribution. Is there any tax benefit that I can claim as a pensioner when reporting the distribution?**

Yes. Every owner or beneficiary of an IRA who receives a total or partial distribution that does not constitute a distribution of his contributions, may elect to pay a 10% tax over such amount, as long as he is receiving the benefits provided by the Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities, the Judicature Retirement System or the Teachers Retirement System.

The option to avail of the special tax rate may be done at any moment before the fiduciary of the account makes the IRA payment or distribution.

- 65. Is it true that some taxpayers elected a 10% special tax rate during the periods of August 1 through October 31, 2002 and July 1 through December 31, 2004, even when they did not withdraw the funds of their IRA?**

Yes. Those taxpayers who elected this special rate, prepaid the 10% over the accumulated funds in their IRA's, without having to withdraw the funds. For this purpose, they filled out the Election for Prepayment of Special Tax for Individual Retirement Accounts, and made the prepayment during these periods.

- 66. When will they claim the prepaid tax? How will the distribution be reported on the return?**

The prepaid tax will be claimed in the taxable year in which the distribution is received. To report this prepaid tax you must use Schedule B Individual. The amount of the distribution attributable to the funds for which the tax was prepaid is not subject to the payment of income tax. However, any amount received in excess of the amount for which the prepayment was made will be taxable. You must submit with your return the Informative Return – Individual Retirement Account (Form 480.7).

- 67. What is a Non Deductible Individual Retirement Account?**

Non Deductible Individual Retirement Accounts (Roth IRA) are an investment instrument under which, contrary to regular IRA's, annual contributions to the same cannot be claimed as a deduction on the income tax return for the particular taxable year.

However, distributions of contributions to said accounts, as well as the increase or benefit derived from them, once the individual reaches the age of 60, are exempt from the payment of income tax.

It is important to point out that **transfers** from an Individual Retirement Account (regular) or from a qualified retirement plan to a Non Deductible Individual Retirement Account, are considered as distributions and the same must be reported on Schedule F Individual for the taxable year of the distribution.

- 68. During the year I won an automobile in a contest. Do I have to inform this prize in the return?**

Yes. If you participate in a contest and you win, the prize constitutes income and must be included in the return. The amount of income to be informed is the fair market value of the article in the year received. You must inform it on Schedule F Individual (Other Income), of the Long Form.

69. I am a married taxpayer and we file separate returns. We both receive interest income from qualified financial institutions. Can we both claim the \$2,000 exclusion?

Yes. In the case of married persons filing separate returns, each one may claim the \$2,000 exclusion.

70. During the year, I terminated my employment and received my distribution from a qualified retirement plan. Do I have to include this income in my return or can I defer the taxation?

To defer the taxation of this income, you must rollover the total amount received to another qualified retirement plan, or to an IRA, within 60 days following the distribution of the benefits under the plan. Otherwise, you must include the distribution in your income tax return, in which case, the income may be subject to the tax rate applicable to long-term capital gains.

71. Is it true that distributions from a qualified retirement plan are subject to a 20% withholding tax?

Yes. As a general rule, lump-sum distributions from qualified retirement plans (one payment or several payments during one year) due to separation from employment are subject to a 20% withholding of tax at source. Notwithstanding, if you comply with certain requirements, said withholding may be 10% or 5%, as indicated below:

- The 10% withholding at source may apply to those distributions that comply with the previous general rule, except that they were received after June 30, 2004, and comply with the requirement of reinvestment in Puerto Rico provided by Act No. 226 of August 22, 2004 (Act No. 226) and the Internal Revenue Circular Letter No. 04-03. This withholding may also apply to distributions that comply with the previously established general rule, but that were received after September 22, 2004 by beneficiaries who have reached the age of 55 or older at the moment of the distribution and that do not comply with the reinvestment requirement under Act No. 226.
- The 5% withholding at source may apply to those distributions that comply with the previous general rule, except that they were received between September 22 and December 31, 2004, and the beneficiary has reached the age of 55 or older at the moment of the distribution and that comply with the reinvestment requirement provided by Act No. 226.

72. If I have not received my withholding statement by January 31, can I file the income tax return without it?

Every return in which a credit for income tax withheld at source from salaries is claimed, must be accompanied with a withholding statement. The fact that the employer has not provided the withholding statement does not exempt the employee from filing the income tax return.

The employee must request the withholding statement to the Human Resources Office of his place of work. If he is not able to obtain the withholding statement, he must notify such failure to the Employer Investigation Section of the Department of the Treasury at (787) 723-5808.

73. My withholding statement shows an amount in Block 15, Contributions to Coda Plans. Can I claim this amount as a deduction in my return?

No, because this amount already has been deducted from your salaries.

74. Are funeral expenses deductible?

Funeral expenses are not deductible in the income tax return. However, these expenses are deductible up to a maximum of \$4,000 in the deceased estate tax return.

75. If I am self employed, can I establish a retirement plan and also make contributions to an IRA?

Yes, in addition to the contributions made to an IRA you can establish your own retirement plan. These plans are known as Keogh Plans. Generally, contributions will be limited to 25% of the net income determined without including the deduction for contributions to any pension or retirement plan.

76. When am I required to file an Estimated Tax Declaration?

You must file an Estimated Tax Declaration, if you are single or married not living with your spouse and received income not subject to withholding (such as interest, dividends, gifts, IRA withdrawal or others) that exceeds 50% of your total estimated gross income from all sources or \$5,000, whichever is lesser. If you are married living with your spouse and your gross income not subject to withholding exceeds 50% of your total estimated gross income or \$10,000, whichever is lesser, you must file such declaration.

However, if the total amount of tax due for the year is \$200 or less, you are not required to file an Estimated Tax Declaration.

77. Is it true that now the return provides to calculate the addition to the tax for failure to pay the estimated tax?

Yes. Schedule T Individual was designed to help taxpayers to determine the addition to the tax for failure to pay the estimated tax and to determine the penalty for the substantial underestimate of the estimated tax. For more details, refer to the instructions of Schedule T Individual included in the booklet of the Long Form return.

78. During the year I sold my house and realized a capital gain. Do I have to file an Estimated Tax Declaration?

Capital gain is one of the items subject to the estimated tax payment. To determine if you are required or not to file an Estimated Tax Declaration, see the rules in question number 76.

79. I own a house that is rented under “Plan 8”. Do I have to include the rental income in my income tax return? If so, can I claim any deductions against such income?

The rental income received under a “Plan 8” is fully taxable and must be informed on Schedule N Individual (Rental Income) of the Long Form. You can claim on that schedule the expenses actually incurred in generating such rental income.

80. During the year I sold a property that I inherited. Do I have to pay taxes on this sale?

Yes. When property acquired through inheritance is sold, the gain or loss must be informed in the income tax return of the heir. The determination of the property’s basis (acquisition cost) will depend on the date it was acquired:

- if the property was inherited on or before June 30,1985, the basis will be the fair market value at the time of the decedent’s death; or
- if the property was inherited after June 30,1985, the basis will be the decedent’s basis.

81. I am a federal government employee. Do I have to file a Puerto Rico Income Tax Return?

Yes. Every federal government employee working in Puerto Rico is required to file an income tax return with the Government of Puerto Rico. For additional information, refer to the Informative Booklet to Provide Orientation on the Income Tax Responsibilities of Federal, Military and Other Employees.

82. Do I have to include in the Puerto Rico Income Tax Return the Cost of Living Allowance (COLA) that I receive as a federal government employee?

The COLA received as a federal government employee will be excluded from gross income limited to the exempt amount granted under the U.S. Internal Revenue Code, as long as the following requirements are met:

- a. you have filed your income tax returns for the last four taxable years, provided you were required to file; and
- b. you have paid the tax determined therein, or in case you have any debts outstanding, you are up to date pursuant to a payment plan.

You must attach to the return the W-2 Form.

83. As a federal government employee, when do I have to send my income tax payment to the Department of the Treasury?

Federal government employees can pay the balance of tax due in two equal installments, if at least 50% is paid with the income tax return. This year, the first installment is due on April 18 and the second installment on October 16.

If the federal government employee has other income in addition to salary, and is required to file an Estimated Tax Declaration, the election to pay in two equal installments will not apply.

84. Someone told me that individuals who sell their principal residence and are 60 years of age or older, can claim an exclusion from the gain realized in the sale or exchange of such property. Is it true?

Yes. In the case of individuals the gain from the sale or exchange may be excluded if such individuals are 60 years or older, and have used the property as their principal residence for at least 3 of the 5

years preceding the sale. For the taxable year 2005 the amount of the exclusion is \$150,000.

85. Which are the special tax rates applicable to long term capital gains?

Every individual, estate or trust shall pay, in lieu of any other tax imposed by the Code, a special tax on the amount of the excess of net long-term capital gains over any net short-term capital loss. Such special tax rate will be 10% in the case of property located in Puerto Rico, or 20% for other properties.

In addition to the above, every eligible person may pay a tax of 7% over the excess of any net long-term capital gain derived from the sale of stock of an eligible corporation or partnership.

However, the previously mentioned special tax rates will be reduced in 50% for certain transactions realized within the period of July 1, 2004 through June 30, 2005 (temporary period), including distributions from qualified pension plans, as indicated in the following table:

CONCEPT	CAPITAL GAIN RATES	CAPITAL GAIN RATES (Transitory Provisions)
Other Properties	20%	10%
Property Located in Puerto Rico	10%	5%
Shares from Eligible Corporation or Partnership	7%	3.5%
Pension Plans	20% or 10%	10% or 5%

To be entitled to this benefit, the taxpayer must comply with certain requirements, among which are the reinvestment in Puerto Rico of the gain realized during the temporary period not later than 60 days from the date in which the transaction occurred, and that such reinvestment must be held for a minimum period of one year from the reinvestment date. For more information, refer to the Internal Revenue Circular Letter No. 04-03.

86. Which are the income tax rates applicable to the 2005 income tax return?

The applicable tax rates for the 2005 return are as follows:

a. Married person living with spouse and filing jointly, married person not living with spouse, single, head of household, estate or trust:

If the net taxable income is:	The tax will be:
Not over \$2,000	7%
Over \$2,000 but not over \$17,000	\$140 plus 10% of the excess over \$2,000
Over \$17,000 but not over \$30,000	\$1,640 plus 15% of the excess over \$17,000
Over \$30,000 but not over \$50,000	\$3,590 plus 28% of the excess over \$30,000
Over \$50,000	\$9,190 plus 33% of the excess over \$50,000

b. Married person living with spouse and filing separately:

If the net taxable income is:	The tax will be:
Not over \$1,000	7%
Over \$1,000 but not over \$8,500	\$70 plus 10% of the excess over \$1,000
Over \$8,500 but not over \$15,000	\$820 plus 15% of the excess over \$8,500
Over \$15,000 but not over \$25,000	\$1,795 plus 28% of the excess over \$15,000
Over \$25,000	\$4,595 plus 33% of the excess over \$25,000

87. If I paid for the preparation of my return, can I request the specialist to sign the return?

Yes. If you paid for the preparation of your return, make sure that the specialist signs it, and that he includes his employer's identification number, and the specialist registration number. Every person who, for payment or other remuneration, prepares any return must be registered with the Department of the Treasury as a Specialist in Returns, Declarations or Refund Claims.

88. Is it true that a new tax credit was approved for persons who only receive income from salaries?

Yes. Every taxpayer who is single, head of household or married filing jointly, whose adjusted gross income does not exceed \$10,000 and whose only source of income consists of salaries, is entitled to claim a tax credit up to the amount of the determined income tax. For this purpose, the term salaries do not include amounts received from annuities or pensions.

To determine this credit the term adjusted gross income means: gross income less the allowable deduction for ordinary and necessary expenses, losses from the sale or exchange of capital assets (subject to the \$1,000 limitation) and alimony payments for divorce or separation allowed under Section 1023(w) of the Code.

89. I heard that there is also a tax credit for persons who only receive salaries and pensions. Is that true?

Yes. Every person who is single, head of household or married filing jointly, whose adjusted gross income is over \$10,000 but does not exceed \$50,000, is entitled to a tax credit, if that person complies with all the following requirements:

- a. the individual or joint gross income does not exceed \$50,000;
- b. the individual or joint gross income is derived only from salaries and wages subject to withholding in Puerto Rico, from pensions or tips; should not receive alimony, interest, dividends, sole proprietorship business or other income;
- c. is not required to file an Estimated Tax Declaration;
- d. is a United States citizen or resident alien;
- e. does not claim a tax credit for taxes paid to a foreign country or for withholding at source for services rendered; and
- f. does not claim any other tax credit, except the credit for Contributions to the Educational Foundation for Free Selection of Schools.

CREDIT AMOUNT

Adjusted Gross Income		Single	Head of household	Married living with spouse and filing jointly
In excess of:	Up to:			
\$10,000	\$15,000	\$50	\$50	\$50
\$15,000	\$20,000	\$80	\$80	\$80
\$20,000	\$25,000	\$120	\$120	\$120
\$25,000	\$30,000	\$150	\$150	\$150
\$30,000	\$35,000	\$0	\$180	\$180
\$35,000	\$40,000	\$0	\$0	\$200
\$40,000	\$45,000	\$0	\$0	\$230
\$45,000	\$50,000	\$0	\$0	\$250

To determine this credit, adjusted gross income means: gross income less the allowable deduction for ordinary and necessary expenses as an employee, losses (subject to the \$1,000 limitation) from the sale or exchange of capital assets, and payments from divorce or separation as provided by Section 1023(w) of the Code.

90. Is it true that I can pay the income tax due with my return through an electronic transfer?

Yes. You can pay the income tax due through an **electronic transfer**. This includes the payment of the first and second installments, or of the total income tax due. In order to make the payment you must contact a participating banking institution and have the following information at hand:

- social security number;
- bank account number; and
- Form AS 2617 (Notice and Request of Payment of Income Tax) sent by the Department of the Treasury, if you are paying the second installment.

When you finish processing the transaction, you must indicate on line 36(b) of the Long Form, or on line 20(b) of the Short Form, the amount paid and the transaction number.

For additional information, please contact the General Consulting Section at (787) 721-2020 extension 3611 or (1) (800) 981-9236.

91. Which are the requirements in order to be able to pay the income tax in two installments?

In order to have the right to pay in two installments, you must comply with the following requirements:

- a. are not required to file an Estimated Tax Declaration;
- b. file the income tax return no later than the last day provided by the Code;
- c. pay 50% or more of the balance due with the return; and
- d. if you request an automatic extension to file, you should pay with the extension at least 50% of the balance due.

92. Is it true that my refund can be deposited directly into my bank account?

Yes. You have to complete Part 5 of the income tax return and include all the information requested therein. Otherwise, the financial institution and the Department of the Treasury could reject the transaction. If you file your return as married living with spouse and filing jointly, the bank account must be in the name of both spouses.

93. What reasons may delay my refund?

Some reasons could be the following:

- a. the taxpayer or spouse's social security number was not included;
- b. evidence of the income tax withholding claimed was not submitted;
- c. the personal status at the end of the taxable year was not indicated;
- d. Schedule A Individual was not completed or did not submit information related to the dependents and beneficiaries of the Educational Contribution Accounts;
- e. the return was not signed by you or your spouse;
- f. information related to the itemized or additional deductions was omitted; or

g. you owe child support payments through the Child Support Administration (ASUME).

94. What other booklets or informative material does the Department of the Treasury have issued to provide additional information?

The Department of the Treasury is constantly issuing informative booklets and materials, for orientation purposes. The following booklets are available and can be obtained at the Department:

- *Carta de Derechos del Contribuyente* (Spanish only)
- Informative Booklet regarding the Withholding at Source in Case of Services Rendered (English and Spanish version)
- *Folleto Informativo sobre la Contribución sobre Ingresos de Sacerdotes o Ministros* (Spanish only)
- *Folleto Informativo para Aclarar sus Dudas sobre Aspectos Contributivos en la Venta de Ciertas Propiedades Inmuebles* (Spanish only)
- *Folleto Informativo de Herencias y Donaciones* (Spanish only)
- Informative Booklet to Provide Orientation on the Income Tax Responsibilities of Federal, Military and Other Employees

Also, the Department of the Treasury has a site in the Internet. Here you can access information about our Mission and Organizational Values, Collection Offices and most of the forms and informative booklets provided by the Department. In addition, you can prepare and file electronically the 2005 Individual Income Tax Return using our system “**Tax Returns Online**”.

You can access our site at:

www.hacienda.gobierno.pr

Also you can let us know your opinion through our E-mail at:

InfoServ@hacienda.gobierno.pr

The Taxpayer's Service Offices are located at:

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For orientation about technical matters you can call:

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