



MOST PUERTO RICO TRUSTS WILL BE TAXED AS GRANTOR TRUSTS

By: Caridad Muñiz-Padilla, Esq.

For taxable years commenced after December 31, 2010, all trusts that are considered “grantor trusts” pursuant to the United States Internal Revenue Code of 1986, as amended (“US-IRC”), or pursuant to an analogous provision of a foreign country,¹ will also be considered “grantor trusts” for Puerto Rico (“PR”) income tax purposes, as provided by the recently enacted Internal Revenue Code for the New Puerto Rico (Act No. 1 of January 31, 2011, the “NPR-IRC”).

These PR grantor trusts will be subject to the provisions of Section 1083.06 of the NPR-IRC (titled “Income for the Benefit of the Grantor”), regardless of when the trust was organized or its place of organization.

Since most of PR organized trusts are considered “grantor trusts” for federal income tax purposes² due to the automatic grantor trust classification rule under US-IRC section 679, they will now be deemed “grantor trusts” for PR income tax purposes under the NPR-IRC. In general, US-IRC section 679 provides that a foreign trust created by a US citizen for the benefit of a US citizen will be considered a grantor trust. A trust created in PR is considered a foreign trust under the US-IRC. However, it should be noted that many PR organized trusts were already considered grantor trusts under the prior PR Internal Revenue Code.

As a result of the grantor trust classification, all income derived by the trust will be deemed earned by and taxed to its grantor, and not by the trust or its beneficiaries. The original trust level characterization and source of the trust’s income losses, credits and deductions will pass-through to the grantor. The grantors, also known as “settlers”, are generally the persons that create and contribute assets to the trust.

The Statement of Motives of the NPR-IRC states that the intent behind this new tax treatment is to eliminate differences in the taxation of the grantor of a PR organized trust for PR and federal purposes.

New Date for Filing Informative Return by Grantor Trusts. Any trust that is considered a revocable trust or a grantor trust under the NPR-IRC must file an informative return (“Grantor Trust Informative Return”) not later than the fifteenth day of the third month following the closing of a taxable year commenced after December 31, 2010 (i.e., March 15 following the closing of a calendar year). The Grantor Trust Informative Return must contain gross income, receipts, disbursements and any other information required by the Secretary of the Treasury.

The trustee of a grantor trust must also remit to the grantor a report including the information required to be included in the grantor’s income tax return (including gross income, deductions, credits and any other information required by the Secretary of the Treasury), not later than the last day of the third month following the closing of the trust’s taxable year commenced after December 31, 2010. The information included in this grantor’s report will presumably be similar (except for specific US-IRC concepts that are not applicable under the NPR-IRC) to the information required to be included in the “Foreign Grantor Trust Owner Statement” contained in page 3 of US IRS Form 3520-A.

¹ This reference to a foreign country presumably refers to a trust organized in such foreign country.

² Testamentary trusts, real estate investment trusts, business trusts, and trusts that are part of pension plans, individual retirement accounts, and educational contribution accounts are not considered grantor trusts under the US-IRC.

The material contained herein is intended for information purposes only, is not to be considered legal advice, and it does not intend to consider all the tax and legal considerations that could be relevant to any particular person. Any person considering this investment should seek the advice of qualified counsel based on his/her particular circumstances.

The contents of PUERTO RICO BUSINESS LAW NOTES may not be reproduced, transmitted, or distributed without the express written consent of ADSUAR MUÑIZ GOYCO SEDA & PÉREZ-OCHOA, P.S.C. (“AMG”). The material contained herein is intended for information purposes only and is not to be considered legal advice. Qualified counsel should be consulted based on individual circumstances.

As required by US IRS rules, please understand that any information contained herein is not written to be used and cannot be used for the purpose of avoiding penalties. We provide formal tax advice only upon completion of a formal written tax opinion in compliance with US Treasury Circular 230.