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Code Sections: 1033.01 and 1033.02

Topic: Income Tax

Act: 1-2011

Date issued: October 25, 2016

Text

By letter of March 26, 2013, you requested, on behalf of Taxpayer, our rulings under the applicable provisions of the Puerto Rico Internal Revenue Code of 2011, as amended (“Code”), as to the proper income tax treatment of insurance agent’s compensation received. Our opinion is based on the following facts submitted for our consideration.

I. STATEMENT OF FACTS

A. Taxpayer’s Information

Taxpayer’s principal business activity is the solicitation of applications for individual insurance, group policies, and annuity policies. The Taxpayer maintains his books under the cash method of accounting on the basis of a calendar year.

B. Facts related to the Compensation

The Taxpayer executed various contracts (hereinafter “Agreements”) with Insurance Company A, in which he receives compensation for the services performed based on commissions (hereinafter “Compensation”). Copies of the pertinent contracts were submitted for our consideration (the “Agreements”).

The Agreements provide that the Taxpayer shall be considered an independent contractor and that nothing within the contracts shall be construed as creating an employer-employee relationship. The contracts also provide that:

- The Taxpayer shall be free to determine the time, place and manner of soliciting the individual insurance, group policies, and annuity policies, and the persons solicited, provided, however, to the extent that such freedom as an independent contractor shall conform to Insurance Company A’s rules; and
- The Agreements also provide the basis for compensation (commissions) which depends on the insurance policy and the volume sold by the Taxpayer.

The Agreements also provide that Insurance Company A may, but shall not be obligated, to provide office facilities, clerical support and supplies for the use of the Taxpayer and that the Taxpayer shall otherwise bear her own expenses, including but not limited to, automobile, travel and entertainment expenses.

The Agreements also states that the Taxpayer is engaged as an independent contractor pursuant to the insurance laws of the state or states in which the Taxpayer is licensed and shall be treated as such for all purposes, including, but not limited to, federal and state taxation, withholding (other than Federal Insurance Contributions Act ("FICA") taxes required for full-time insurance agents pursuant to Section 3121(d)(3) of the Federal Internal Revenue Code (hereinafter "US Code")), unemployment insurance, and workers' compensation.

Although the Taxpayer is not considered an employee for Puerto Rico income tax purposes, he receives a Form W-2. Insurance Company A withholds FICA taxes, pursuant to Section 3121(d)(3) of the US Code and its regulations.

C. Additional Facts

- The Taxpayer may represent other insurance companies apart from the Insurance Company A.
- The taxpayer may realize losses upon rendering the service.
- The Taxpayer is not eligible for vacations or sick leave pay.
- The office space used by the Taxpayer to render the services is rented.
- The equipment used by the Taxpayer to render the services is personally owned.
- The risk of loss of such equipment used to render the services is assumed by the Taxpayer.
- The Taxpayer doesn't have a substantial investment in facilities used for doing the work, other than transportation facilities.
- The Taxpayer doesn't have a working schedule during which she renders services to the business.

II. **RULINGS REQUESTED**

1. The Taxpayer is considered an independent contractor under Section 1033.02 of the Code, and therefore, is entitled to deduct all ordinary and necessary expenses paid during the tax year against the income derived from the services performed to Insurance Company A under the Agreements.

2. The employer portion of the FICA Tax that must pay Insurance Company A on behalf of the Taxpayer, as required un Section 3121(d)(3) of the US Code, does not constitutes income under Section 1062.03 of the Code.
3. The Compensation will be subject to a seven percent withholding, unless the Taxpayer authorizes Insurance Company A to withhold, in lieu of the seven percent, an amount equal to ten percent, or fifteen percent from such payments.

III. LAW AND ANALYSIS

Section 1033.01(a) of the Code provides a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. This deduction refer to expenses related to the principal trade or business. On the other hand, Section 1033.02(a) of the Code provides a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income, or in the conduct of one or more trades or businesses other than the principal trade or business, up to the amount of the gross income derived from said activity, trade or business. This deduction refer to expenses not related with a principal trade or business. As represented, the Taxpayer's principal trade or business is the solicitation of applications for individual insurance, group policies, and annuity policies.

Section 1033.02(c) of the Code specifically provides that the compensation received by a taxpayer from the rendering of services as an employee, as said term is defined in Section 1062.01(a)(3) of the Code do not constitute a trade or business for purposes of Section 1033.01 of the Code, nor an activity described in Section 1033.02 of the Code. Therefore, no expenses may be claimed against a compensation received as an "employee".

Pursuant to Section 1062.01(a)(3) of the Code, the term "employee" includes an officer, employee, or elected official of the Government of Puerto Rico or any political subdivision thereof, or of any agency or instrumentality of any of the foregoing. The term "employee" also includes an officer of a corporation. Article 1062.01(a)(3)(1)-1 of the Regulation under the Code states that the term "employee" includes every individual performing services as long as the relationship between him and the person for whom the services are performed is legally considered as between employer and employee. Generally, the employer-employee relationship exists when the person for whom the services are performed is entitled to control and direct the individual who performs the services, not only as to the results to be accomplished by the work, but also as to the details and means used to achieve them. An employee depends on the will and control of an employer not only regarding what to do but also, how to do it. In this respect, it is not necessary that the employer personally direct and control the manner in which the services are performed; it is sufficient that he is entitled to do it. The right to discharge is also an important factor, indicative that the person who holds it is an employer. Article 1062.01(a)(1)-1(b)(3) of the Regulation under the Code provides other factors characteristic of an employer-employee relationship, but not necessarily present in every case. In general terms, if an individual depends on the control or direction of another only for the job's achievements and not for the means and methods to get said results, is not an employee. An analysis of the facts submitted for our consideration provides that relevant

factors described in Article 1062.01(a)(3)(1)-1 of the Regulation under the Code are not present in the Taxpayer's relationship with Insurance Company A pursuant to the Agreements. Therefore, the Taxpayer should not be considered an "employee" under Sections 1062.01 or 1033.01(a) of the Code, and therefore, should be allowed to deduct ordinary and necessary expenses paid or incurred in connection with its principal trade or business, which is the solicitation of applications for individual insurance, group policies, and annuity policies, including amounts paid by Insurance Company A to the Social Security, Medicare, and/or pension plan accounts of the Taxpayer, if any.

Section 1031.01(a) of the Code states the general rule that "gross income" means all income, gains, or profits from whatever source received or derived, including but not limited to, gains, profits and income from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether personal or real, growing out of the possession or use of or interest in such property. Therefore, any expenses paid by Insurance Company A on behalf of the Taxpayer, including, but not limited to, Social Security, Medicare, and pension plan contributions, if any, shall be included as gross income.

Section 1062.03(a) of the Code provides that every person, natural or juridical, that in the conduct of a trade or business or for the production of income in Puerto Rico, makes payment to another person for services rendered shall deduct and withhold seven (7) percent thereof. Nevertheless, at the election of the service provider, the payor may deduct and withhold, in lieu of the seven (7) percent, an amount equal to ten (10) percent, or fifteen (15) percent of such payments. Section 1063.01(a) of the Code provides that all persons engaged in trade or business in Puerto Rico making payments to individuals for compensations of five hundred (500) or more shall file, on or before February 28 of the following year, a true and accurate return to the Secretary setting forth the amount of such gains, profits and income, and the name, address and account number of the recipient of such payments. These items are reported to the Secretary in form 480.6A, if the income was not subject to withholding, or in Form 480.6B, if the income was subject to withholding.

IV. CONCLUSION

Based solely upon the facts and documents submitted for our consideration, the provisions of the Code, and of the applicable Regulations, this Department rules that:

1. The Taxpayer is considered an independent contractor and, therefore, is entitled to deduct the corresponding ordinary and necessary expenses of his principal trade or business during the tax year pursuant to Section 1033.01 of the Code, against the Compensation and any amounts paid by Insurance Company A to the Social Security, Medicare, and/or pension plan accounts of the Taxpayer.
2. Any amounts paid by Insurance Company A to the Social Security, Medicare, and/or pension plan accounts of the Taxpayer are considered gross income. This income, together with the Compensation, should be informed to the Taxpayer in a Form 480.6B for tax years 2013 onwards.

3. The Compensation and any amounts paid by Insurance Company A to the Social Security, Medicare, and/or pension plan accounts of the Taxpayer will be subject to a seven percent withholding, unless the Taxpayer authorizes Insurance Company A to withhold, in lieu of the seven percent, an amount equal to ten percent, or fifteen percent from such payments pursuant to Section 1062.03 of the Code.

No opinion is expressed as to the tax treatment of the compensation under any other provision of the Code and the applicable Regulations that may also be applicable thereto, or as to the tax treatment of any condition existing at the time of the transaction or any effect resulting therefrom, that is not specifically covered by this ruling. This ruling is based on the factual representations as described above. Any misrepresentation or hiding of a material fact shall render this ruling null and void. The opinion expressed herein shall be valid only upon the continued existence of the facts as submitted for our consideration. This letter ruling is directed only to the taxpayer requesting it and may not be used or cited as precedent.

A copy of this ruling letter shall be attached to the Taxpayer's Puerto Rico Income Tax Return in every taxable year that the Taxpayer receives income from the Agreements.

Cordially,

CPA Elisa Vélez Pérez, Esq.
Assistant Secretary