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Time to buckle up as Puerto Rico Treasury muscled up to enforce PR income tax evasion dispositions

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Are you happy that your number of YouTube subscribers is growing or that your followers in your Insta account are multiplying? If your income tax return does not reflect this growth, you may be liable for tax evasion. As any other taxpayer, Youtubers, Influencers, and Bloggers are required to declare their income received from these activities in their individual income tax returns. Staying compliant with your income tax responsibilities should be a top priority. Especially nowadays, as the Puerto Rico Department of Treasury ("PRDT") has increased its scrutiny in this area and has been noticeably public about it. In this article, we take a closer look at tax rules for influencers in Puerto Rico ("PR") and the implications they may face for failing to comply with your income tax responsibilities.

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I. First Steps in the PRDT Compliance Campaign

It is no secret that the PRDT has been closely following the social media revenue streams that enter its coffers as the industry continues growing. In PR Internal Revenue Administrative Bulletin 21-03 issued by PRDT in 2021, the agency informed that one of its key priorities is to focus its audit and investigation processes on several compliance areas, including, income tax payments and information reporting related to taxpayers (e.g., *influencers*) that receive payments for their participation and use of digital platforms. In addition, the PRDT expressed the IRS had agreed to collaborate with them by sharing information from residents of Puerto Rico reported at the federal level.

Roughly a month later, the PRDT issued Internal Revenue Circular Letter 21-11 (IR CC 21-11) to summarize the implications of prizes, gifts, and "giveaways" often shared through social networks and set crystal clear the tax rules that apply to *influencers*.

The publication further recognizes *influencers* as people with the power to affect decisions of companionship, lifestyle, and behavior of others due to their relationship with their audience; or that have a group of followers in some social network with which they actively interact.

As a result, brands often seek to partner with them to promote their products or services through their expanded network. They are normally paid by the brand as independent contractors and might receive informative returns such as Form 480.6A, Form 480.6SP, or Form 1099-MISC reporting their income. They may also be considered merchants for purposes of the Sales and Use Tax, and thus be required to apply for a Merchant Registry.

Common reportable income streams from social media include:

1. ***Sponsored posts:*** brand hires an *influencer* to create content with the brand and share it with their followers. If a product is gifted as part of the sponsorship the market value of the product must be reported as income.

2. ***Digital products:*** commission on the sale of e-books, promotional brochures, or co-creation of content with brands. *Influencers* can sell such e-books to their followers or receive payment from the brand for each click or download.

3. ***Sale of advertising space:*** A brand rents space from the influencer to promote a product through a click ad or an advertising article.

4. ***Webinars and podcasts:*** *Influencers* can charge consumers to access content, collaborate with a brand to produce content, or use the format for lead generation.

The publication also emphasizes that if the brand offers a paid stay to the influencer, the value of such stay must be reported as taxable income as well.

On a related note, the PRDT states that giveaways are, as a general rule[1], gifts reported and taxed at market value on the tax year the winner won the prize. These gifts are taxable since they require actionable steps from the giveaway participants to be won (i.e., share content, tag followers). This holds true regardless of whether the prize was in cash, in kind, or an experience (for example, paid vacations). Additionally, the person or entity awarding it must report the giveaway on Form 480.6A- Informative Statement- Other Income Not Subject to Withholding ("Form 480.6A") when the value of the gift is greater than $500. Please note that to deduct the expense of the prize, the sponsor must file the form even if the value is less than $500.

II. Further Criminal Enforcements

The PRDT's increased oversight aims to tackle the growing tax evasion and fraud cases by *influencers* on the Island and has begun enforcing tax evasion mechanisms as displayed through the media outlet in 2022. One of the recent cases of tax evasion is from an influencer and speaker who pled guilty to four charges for failing to report $11 million in his income tax returns for the years 2017 to 2022. Another YouTuber who allegedly failed to report millions of dollars in his income tax return and filed false and fraudulent returns with the PRDT has been charged and awaits the judicial process. The Secretary of the PRDT ("the Secretary"), Mr. Francisco Parés Alicea highlighted this case as one of the most sophisticated cases of tax evasion seen in Puerto Rico.

We will dive into mechanisms available in PR to penalize and prosecute taxpayers that engage in tax evasion and/or tax fraud.[2] We will also look at different variants of tax evasion and navigate through the monetary penalties and imprisonment charges imposed by the Puerto Rico Internal Revenue Code ("PRIRC").

[1] Certain academic or professional prizes may be excluded from gross income if they meet specific criteria.

[2] Note that there is a difference between tax evasion and tax avoidance. Tax evasion is intentionally concealing income from tax authorities, while tax avoidance is legally reducing your taxable income. Our discussion focuses on tax evasion and fraud.

The PRIRC imposes a combination of penalties and criminal charges on taxpayers violating its income tax dispositions. In the section below, we mention some of them.

III. Summary of Administrative Penalties and Criminal Charges

Failure to submit information or pay tax

If you intentionally fail to comply with your obligation to pay, file any return or keep records and information you may be subject to penalties, additions to tax or imprisonment. This failure to comply could be cataloged either as a misdemeanor (which is subject to a fine not more than $5,000 dollars or imprisonment for a term of not more than 90 days, or both) or a felony (which is subject to imprisonment for 8 years and or a penalty of not more than $20,000 dollars). Through a recent amendment, the Secretary must now certify the amount due on such regards.

Fraudulent filings

If you willfully deliver to the Secretary, fraudulent returns, statements, information, documents or assist in the preparation or presentation of these with the knowledge that are false, you may be charged with a felony in the third degree.

Failure to collect taxes or make required withholdings at source

If you are a principal operating officer, president, principal accounting officer, comptroller and any official in a similar position of an entity or person and you are responsible to collect and pay the sales and use tax or withholding tax at source, and willfully and knowingly fail to collect them, you can be subject to a fixed penalty of 3 years of imprisonment.

Failure to file an information return

If you willfully procure, counsel, incite, and conspire for your own benefit or the benefit of a financial entity or brokerage business, with or without its authorization, and the business omits to file the information return, you may be charged with a felony in the third degree.

Failure to pay or deposit income tax on wages

If you fail to pay or deposit income tax on wages, you are exposed to a penalty from 25% to 50% of the amount not reported, unless you demonstrate to the PRDT's satisfaction that the cause of failing to comply was due to circumstances beyond your control. For repeated offenders, the penalty can increase to 100%.

Failure to pay estimated tax or underpaying it

If you fail to timely pay or make an incomplete payment of an installment of the estimated tax, you may be subject to an addition of 10% percent to the tax of the unpaid amount.

IV. Statute of Limitations

For how long are you at risk?

It depends on the case. As a rule of thumb, the period of limitation upon assessments is 4 years after the return was filed. This means that generally, after the expiration date of the limitation period, no processes in court can be initiated without an assessment for the collection of taxes (collection proceedings with an assessment can be initiated). However, certain exceptions apply. For example, if you omitted from gross income an amount that exceeds 25% of the gross income reported in the return, the tax may be assessed and collection processes in court may begin **without** assessment at any time within 6 years after the return was filed. The same 6-year rule will apply if you omit from gross sales or purchases an amount that exceeds 25% of the gross income reported in the Monthly Sales and Use Tax return.

The PRIRC lists certain exceptions to the statute of limitation where the tax may be assessed and collected at any time or over an expanded period of time under special rules. Some of these exceptions are:

- False or fraudulent returns or statements with the intention to evade taxes
- Failing to file a return
- Property gifted or received from an estate having an inconsistent basis valuation for income tax purposes versus for estate or gift tax purposes
- When the assessment of any income has been made within the statute of limitation.
- Deficiencies in the gain upon a sale or exchange of residence
- Voluntary waiver

As mentioned above, the PRDT has implemented strategies and investigations for the compliance of tax matters related to the income reporting of *influencers*, youtubers and content creators. It is paramount to be aware of all the requirements discussed and take action as needed in order to comply and prevent any penalties, fines or imprisonment.

We continue with our commitment to keeping you up to date with these tax-related developments. We will be glad to assist you and serve all your PR tax compliance needs to ensure you do not fall into one of these processes. In addition, we can run a compliance check-up to identify exposure areas and address them before they fall into the hands of the PRDT. We also support taxpayers in the voluntary disclosure processes with the Puerto Rico Department of Treasury. Please contact our Tax Department should you require additional information regarding this or any other tax issue.

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