

November – December 2007

Tax Newsletter

We want to be part of your success



Meet our tax management team: Carmen Hernández, (sitting); Eyla Márquez and Isabel Hernández (front row) and Lina Morales, Ida Rosa and María de los A. Rivera (back row).

In this edition we provide you a summary of Act No. 168 of November 9, 2007 related to the extension of the Tax Incentives Act of 1998. We also discuss the special tax rate applicable to interest paid to individuals, estates and trusts. Finally, we summarize P de la C 3750, which establishes the new special capital gain tax rates.

Kevane Grant Thornton LLP

One year after the effectiveness of Act No. 117 of July 4, 2007 (the “Act”), merchants and customers are still adapting to the implementation of the sales and use tax. Notwithstanding this fact, Treasury is being very rigorous with the implementation of the Act and is already conducting investigations and visiting the merchants’ premises to ensure compliance with the provisions of the Act. Many businesses are not prepared to assume the risks and potential exposure of a sales and use tax audit from Treasury. It is also important to mention that the costs associated with an audit can rapidly accumulate, taking into consideration that the penalties imposed by the sales and use tax provisions are very onerous.

Kevane Grant Thornton can perform a “sales and use tax physical” to find out if the procedures followed by your company are in compliance with the Act.

By engaging in this type of review, you will have assurance, to a certain extent, that the procedures that you have established are adequate to comply with the requirements of the law.

At the end of the project, you will receive a full report detailing our findings and any possible exposure. In addition, we will provide our recommendations for improvement in any area found deficient.

Please contact our Tax Department to discuss whether a “sales and use tax physical” is a viable option for you.

María de los A. Rivera
Tax Partner

Effectiveness of the Tax Incentives Act of 1998 is extended

The Tax Incentives Act of 1998 ("TIA") was principally created to increase the labor force in Puerto Rico and to develop the direct investment of property, training and the research and development in Puerto Rico. The TIA provides several income tax benefits such as a flat income tax rate ranging from 2% to 7%, special deductions for property investment, research and development, and the payroll deduction among others. In addition, the TIA provides a 90% property tax exemption and a 60% municipal tax exemption.

The TIA has been in effect since January 1, 1998 and its stated effectiveness was for a period of ten years, which expires on December 31, 2007. Therefore, tax exemption grants based on the provisions of the TIA cannot be requested after December 31, 2007.

However, it is pertinent to mention that tax exemption grants that were approved and issued on or before December 31, 2007, will be effective for the tax exemption period provided on the grant, regardless if such period extends beyond the expiration date of the TIA.

After months of discussions and negotiations among the private sector, the Governor and the Legislature, an agreement was reached to extend the provisions of the TIA. Act No. 168 of November 9, 2007 extends the duration of the TIA until June 30, 2008 ("Act 168"). Finally, Act 168 provides that a new tax incentives act shall be approved by the House of Representatives on or before May 15, 2008, by the Senate on or before May 25, 2008, and by the entire Legislature on or before May 31, 2008 in order for the Governor to sign it on or before June 30, 2008.

Keep in mind, that the Industrial Tax Exemption Office will accept new applications under TIA until June 30, 2008.



Special income tax rate for interest paid to individuals, estates and trusts

On July 13, 2007 the Governor signed Act No. 64 which provides a new special income tax rate of 10% for the interest paid or accredited to depository accounts held in financial institutions, cooperatives, associations or any other banking organization authorized to do business in Puerto Rico. It is important to mention that the interest paid or accredited to individual retirements accounts will remain taxed at the special rate of 17%.

Requirements

The option to pay the special rate of 10% is available to those taxpayers who notify the financial institution that he/she is electing to pay the 10% special tax. This election should be made at the time of opening the bank account that yields interest or April 15 of each taxable year, whichever occurs first. On the other hand, the election to pay the 17% special tax on individual retirements accounts can be made at the moment the payment is received or the account is distributed.

Please bear in mind, that if the elections are not made, all the interest paid will be taxed at ordinary income tax rates.



Proposed new capital gains tax rates

As you may know, during 2005 the preferential income tax rates applicable to long-term capital gains were uniformed to 12.5% for individuals, estates and trusts and to 20% for corporations and partnerships. These rates were applicable to transactions that took place on taxable years beginning after June 30, 2005. However, the effectiveness of these provisions expired on June 30, 2007, therefore it is not clear which preferential tax rates would be applicable to capital transactions that are completed on or after July 1, 2007.

In light of the above, House Bill No. 3750 is proposing a preferential tax rate of 10% in the case of individuals, estates or trusts. This tax rate would be applicable to any type of capital assets regardless of its location or nature. In the case of non-resident aliens, the special tax rate would be 25%.

For corporations and partnerships, the Bill proposes a special tax rate of 15%.

In the case of pension plan distributions, the special tax rate would be 10% if the plan complies with the following requirements:

- the trust is organized under the laws of the Commonwealth of Puerto Rico or has a Puerto Rico resident trustee and uses such trustee as payment agent; and
- ten percent of the total assets of the plan has been invested in property located in Puerto Rico.

If the plan does not comply with these two requirements the applicable special tax rate would be 20%.

The House of Representatives and the Senate have already approved this Bill. At this time, it is pending for the Governor's signature.

Other tax matters

Remember that the Partial or Full Waiver Withholding Certificates for year 2008 will be mailed directly from the PR Treasury Department during the month of December 2007. If you qualify for one of these certificates and do not receive it you can contact us and we will gladly assist you in obtaining the same.

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