



Tax newsletter

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Managing in tough times

Expectations of change that heralded the new administration were quickly dashed by bad news. Agency by agency reported the sorry fiscal situation of Puerto Rico's government. The island's economic landscape presents a continuing challenge.

Gov. Luis Fortuño appointed a fiscal advisory board, known by its Spanish acronym CAREF, to analyze the crisis. The group of prominent executives made recommendations in different areas of the government and public policy. In this issue, we list key proposals of the report on fiscal reconstruction, which the board submitted on Jan. 8, 2009. The complete report to the governor can be found at fortaleza.govpr.org

There has been no shortage of criticism of the CAREF proposals. We are not endorsing the board's extensive recommendations as the solution to all our financial problems,

but we believe they are a serious undertaking. The recommendations encourage open discussion among public and private sectors interested in working towards what is best for Puerto Rico. Overall, CAREF fulfilled its mission, providing short-, medium and long-term proposals to heal Puerto Rico's grave fiscal condition. Their recommendations went beyond revenue-producing measures, even reducing payroll and other expenses.

In this issue, we also provide a list of recently filed tax bills in the Puerto Rico Legislature and a summary of the changes to the 2008 Puerto Rico Individual Income Tax Return.

María de los A. Rivera
Tax Partner



Remember to provide your 2009 withholding waiver certificate to your clients in order to avoid unnecessary tax withholdings.

Have you looked at the 2008 Puerto Rico individual income tax return?

Under Law 117, (the Tax justice law) “Ley de justicia contributiva”, several tax changes went into effect during tax year 2008. These are reflected in the recently issued 2008 Puerto Rico Individual Income Tax Return. These changes include the following:

- new schedule CO for the special tax computation for married couples filing a joint return when both work. This computation allows spouses to individually determine their taxes.
- pension income to be excluded has increased as follows:
 - from \$10,000 to \$11,000 for taxpayers younger than 60 years,
 - from \$14,000 to \$15,000 in the case of those 60 years or older.
- exemption for dependents increased from \$1,600 to \$2,500.
- increase deduction for ordinary and necessary expenses from 3% to 4%, but always limited to

\$1,500.

- deduction for education expenses for dependents increased to \$1,500 for one dependent and \$3,000 for two or more, regardless of the grade level of the dependent.
- deduction for childcare expense increased to \$1,500 for one dependent and \$3,000 for two or more.
- a 100% deduction for donations to the Museo de Arte de Ponce.
- an additional deduction for contributions made to the Endowment Fund of the University of Puerto Rico after July 15, 2008.
- the employment credit increased to \$300.
- a \$2,000 credit for the purchase of a vehicle powered by alternative or mixed energy sources.
- a new tax credit for the acquisition and installation of solar equipment. The amount of the credit will range from 75% of the cost to 25% of the cost depending on year

in which the credit was granted by the Secretary of the Treasury.

REMINDER RE contributions to IRA's and retirement plan:

You have until the extended filing deadline of your income tax return to make the following contributions:

- \$5,000 contribution to your IRA,
- \$5,000 contribution to your spouse's IRA,
- \$500 contribution to a qualifying dependent's educational IRA,
- Contributions to a “Keogh” plan established on or before December 31, 2008.

Keep in mind that if you participate in a cash or deferred agreement (“401K” plan), your total plan and IRA contributions cannot exceed \$8,000 for 2008. This amount will increase to \$9,000 for 2009.



The “CAREF” proposals in brief

On January 8, 2009, the Consejo Asesor de Reconstrucción Económica y Fiscal (“CAREF”) issued its final first recommendations to the governor.

Last November, Puerto Rico’s newly elected chief executive appointed the fiscal advisory board and assigned CAREF with the task of studying Puerto Rico’s current situation and making recommendations in fiscal reconstruction, private-public alliances and economic reconstruction.

The proposals in the January report cover the first two areas; it is expected that a second report, to be issued by March 31, 2009, will tackle the area of economic reconstruction.

Among the recommendations made public are those dealing with increasing revenues and paring expenses. Some recommendations regarding stabilizing the government debt and guaranteeing payroll have already been put into effect.

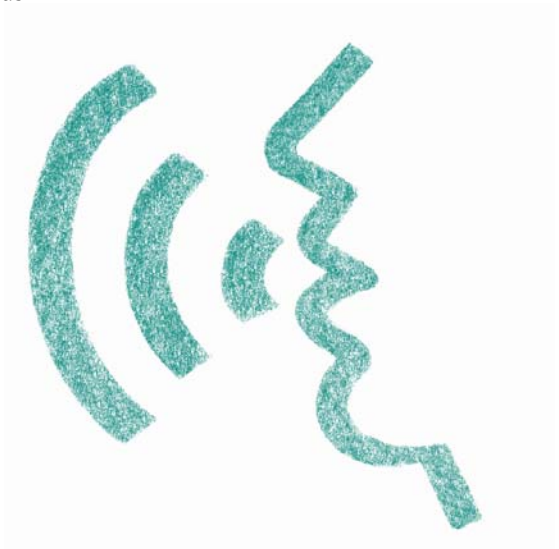
We have divided the proposed measures into short-term and permanent categories.

- Short time measures to increase revenues:
 - a two-year moratorium for the issuance of tax credits.
 - a 5% tax surcharge on all taxable corporations.
 - a 5% tax surcharge to individuals with adjusted gross income in excess of \$100,000 during years 2009-2011.
 - reduction of the exoneration of real property tax on the principal residence starting in fiscal year 2009-2010; in addition, the imposition of a state wide real property tax for two years to be assessed upon the value of the property that loses exoneration.
- Permanent measures to increase revenues:
 - a one-cent per minute excise tax on cellular communications until 2012.
 - increase the gasoline tax to 40 cents from 16 cents per gallon
 - fix sliding tax on crude oil at \$6 per barrel
 - a 50-cent increase on the excise tax per cigarette package
 - an increase in alcoholic beverage taxes
 - establish a voluntary tax compliance program
 - increase enforcement of the collection of the sales tax (IVU)
 - establish a real property tax self assessment system.



The “CAREF” proposals in brief... continued

- review of the types of income included in the computation of the alternative minimum tax.
- short term measures to reduce public expenses:
 - temporary reduction of the daily work schedule in agencies that may be consolidated
 - a two-year moratorium on the economic clauses of the collective bargain agreements.
- permanent measures to reduce public expenses:
 - a ban on creating new positions and the “freeze” of vacant positions due to retirement or the resignation of an employee
 - a 33% reduction in the number of transitory, irregular or trust employees
 - the elimination of positions of those employees hired after July 1, 2008.
- eliminating cash payment of excess accumulation of vacations and sick leave
- a 10% saving on costs incurred by every agency.
- reorganizing the executive branch through consolidation of agencies.
- a 10% cost reduction in the Legislature.
- eliminating the Electoral Fund (Fondo Electoral) and the Matching Fund (Fondo de Pareo).
- reducing the amount of funds assigned to the Municipalities.
- reducing the deficit of the Administration of Health Insurance of Puerto Rico.
- financial measures:
 - restructuring debt service.
 - sale of securities held in the Infrastructure Development Fund
- the current monetization of future Lottery games.
- the assignment of an additional 1% of the sales tax to COFINA (the entity created to receive the assignment of a percentage of the IVU collections in order to issue and sale bonds to obtain funds to refinance the extra-constitutional debt).



What is “cooking” in the new legislature?

In less than a month, the new and not-so-new legislators wrote a large number of bills that cut taxes or granted tax credits. If passed, these would further exacerbate Puerto Rico’s precarious fiscal condition. Here’s what’s on the legislative agenda of the Senate (PS) and the House (PC).

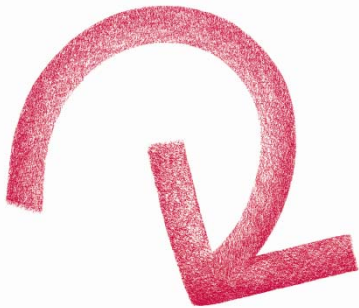
- PS 241 proposes cutting individual income tax rates and exempting individuals with adjusted gross income of \$30,000 or less.
- PC 113 proposes a tax credit for the total expense incurred in the improvement, maintenance and landscaping of an adopted installation.
- PC 338 proposes a total property tax exemption on the principal residence of retirees of the Retirement System of the Commonwealth of Puerto Rico, the Judicial System and the Teachers’ Retirement System.
- PC 397 proposes to increase the income tax exclusion for pensions

from \$11,000 to \$12,000 for those younger than 60 and to \$20,000 for those 60 years old and older.

- PC 420 proposes a \$2,000 deduction for those taxpayers that have their dependents enrolled in a private school.
- PC 445 proposes an IVU exemption on those articles disposed of by a merchant at no charge.
- PC 508 proposes similar benefits for civilians working in a combat zone as those benefits granted by law to military personnel: total income tax exemption, up to six months after leaving combat zone to file income tax returns, etc.
- PC 604 proposes a total credit for the expenses incurred in the maintenance, improvements and landscaping under programs such as Adopt a road, a beach, etc.
- PC 670 proposes an IVU exemption on the admission to sport events promoted by the Olympic Committee of Puerto Rico.

- PC 773 proposes that no income tax withholding be made on the liquidation of vacations and sick leave when a government employee retires or is totally separated from service.
- PC 791 proposes a tax credit to businesses in Puerto Rico of up to 25% of the increase in their payroll related to an increase of the federal minimum wage in Puerto Rico.

Similarly, we find two bills filed that propose the establishment of incentive payment plans for the Puerto Rico Treasury Department (income tax debts), PC 616, and the CRIM (real and personal property tax debts), PC 424.



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