

Special points of interest:

- Sales and Use Tax Municipal Uniformity
- Uncertainty on Special Long-Term Capital Gains Tax Rate
- Recent Tax Legislation
- New Procedures for Representatives Resolving Tax Issues with Treasury

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Sales and Use Tax Municipal Uniformity, not quite there yet

By Juan C. Zaragoza

Bill Number 3190 of the House of Representatives is, as of the date of this newsletter, pending the Governor's signature for its enactment. This bill amends the Sales and Use Tax ("SUT") provisions of the 1994 Internal Revenue Code, as amended, dealing with the Municipalities' authority to impose a Municipal SUT. In general terms, the bill requires all the 78 municipalities of Puerto Rico to impose a 1.5% SUT (the "Municipal SUT"); establishes that the P.R. Treasury Department will be responsible for collecting one third of the Municipal SUT or .50% and the municipalities the remaining 1% and imposes certain limitations on the use by the municipalities of portion of the SUT collected by Treasury.

Currently, most of the 78 municipalities in Puerto Rico are imposing a Municipal SUT. Of those, only San Juan imposes a 1% rate Municipal SUT while the remaining ones impose the tax at a 1.5% rate. To increase even more the lack of uniformity very few municipalities have entered into agreements with Treasury under which the Municipal SUT is paid together with Treasury's monthly SUT return. In addition, municipalities have been granted the authority (i.e. they are not required) to tax food and food items, which are currently exempt from the State level SUT. All these factors put

together, in addition to municipal registration requirements create a nightmare for business carrying out business in multiple municipalities. For example, one of our clients is currently required to file seventy eight municipal SUT returns and various State level returns, one for each of its business locations. All these requirements increase compliance costs and promote noncompliance with the law.

Under Bill 3190 the lack of municipal uniformity is partially addressed in a way which we believe is a step in the right direction. On one hand, requiring all municipalities to impose a 1.5% SUT eliminates different tax treatments for the same transactions depending on where the sale was considered to occur. However, the following issues still remain to be addressed:

- Municipalities will still be allowed to impose and collect directly their SUT, unless an agreement is entered into with Treasury. Therefore business will still be required to file the Treasury return as well as the corresponding municipal returns.
- Municipalities will still be allowed to decide whether or not they want to tax food and food items, which currently are and will continue to be exempt at the



State level, except for purposes of the .50% of 1% of the Municipal SUT that Treasury has the responsibility to collect.

- Businesses are still required to comply with registration and exemption request requirements at both the State and Municipal levels.

Bill 3190 will become effective immediately after the signature by the Governor of Puerto Rico, except for Treasury's obligation to collect the .50% of 1% of the Municipal SUT which is deferred until August 1, 2007. The effective date of the bill will trigger the following issues for local business which will require immediate attention:

- Bill 3190 requires the municipalities to impose the

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Sales and Use Tax...**

Special Long-Term Capital Gain Rate Uncertain

By Felipe Mariani

For years taxpayers in Puerto Rico have enjoyed preferential long-term capital gain tax rates to reduce their income tax burden on the sale of capital assets, assets used on industry or business and even on pension plan distributions. However, since June 30, 2007 those taxpayers are no longer certain at what rate their long-term capital gains are going to be taxed. The reason for such an uncertainty is the effectiveness clause in Act 40 of August 1, 2005 ("Act 40") which established that the act was going to be in effect until June 30, 2007.

On August 1, 2005, the Governor of Puerto Rico signed Act 40 into law. This Act amended the provisions dealing with the preferential long-term capital gain rates for individuals and corporations as well as the provision excluding long-term capital gain from gross income when individuals paid the preferential long-term capital gain rate. Before Act 40, the Puerto Rico Internal Revenue Code of 1994, as amended (the "Code"), provided for a special long-term capital gain rate for individuals of 7% for initial public offerings, 10% for certain property located in Puerto Rico and 20% for all other long-term capital gains. The Code also provided special long-term capital gain rates for corporations of 12.5% for certain property located in Puerto Rico and 25% for all other long-term capital gains. Act 40 amended such provisions and established a 12.5% special long-term capital gain rate for individuals and a 20% special long-term capital gain rate for corporations.

The problem with Act 40 is that it was enacted by the Legislature as a temporary provi-

sion, since it was enacted to last until June 30 2007 subject to the approval by the Governor of the Joint Resolution for the General Budget of fiscal year 2006 (2005-2006). However, although the Governor approved Act 40, such joint resolution was vetoed by him. This amendment of permanent provision by a temporary legislation leaves taxpayers in a twilight zone once the legislation ceases to be effective. This uncertainty needs to be solved preferably by legislation.

The Puerto Rico Government is aware of the problem created by Act 40 effectiveness clause and presented an amendment to the Code. The amendment was approved by the House of Representative but was never presented to the floor of the Senate before the

end of the ordinary session. It is expected that such an amendment be presented once again at the commencement of the next ordinary session in mid August. Once the amendment is presented again, we should pay close attention to the process as the amendment must be effective to transactions effectuated after June 30, 2007. It is not anticipated that the Governor of Puerto Rico will call for an extraordinary session to approve a law dealing with this issue.

If no action is taken by the Legislature, there are two possible interpretations of the effectiveness clause of Act 40. One of them, however, depends on the final outcome of the class action case dealing

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Act 40 is a temporary legislation that amends provisions of the Code which purposes seem to be of a permanent nature. The amendment of permanent provisions by a temporary legislation leaves a void once the legislation ceases to be effective.

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SUT and further provides that failure to enact a municipal ordinance will not affect such obligation, therefore all municipalities which have not enacted a SUT will be required to impose and collect it upon the Governor's signature of bill. Those municipalities without municipal ordinance will not be able to collect SUT on food and food items since Bill 3190 requires the approval of the Municipal Legislature.

- Bill 3190 requires all municipalities to impose a 1.5% SUT; however it segregates the responsibility for its collection between the municipalities (1%) and Treasury (.5%). This creates a mismatch between Treasury's responsibility

to collect the .5% Municipal SUT which is effective on August 1, 2007 and the municipalities' obligation to impose the whole 1.5% Municipal SUT, which will begin upon the signature by the Governor. Although it could be argued that as a result of such language, the municipalities which are currently imposing and collecting a one and a half (1.5%) percent Municipal SUT, will be required to reduce such percent to one percent (1%) beginning on the date of the enactment of the law and up to July 31, 2007, we believe that the municipalities obligation to impose a 1.5% immediately upon the enactment of the act (even if no municipal ordinance is enacted) will require businesses to continue collecting the 1.5% Municipal SUT or to begin collecting a 1.5% Municipal SUT in those municipalities

which are not currently imposing it, and remit the tax collected on its entirety to the corresponding municipality.

- Businesses will be required, to comply with registration and filing requirements with the municipalities which will commence imposing the Municipal SUT upon the enactment of the act.

The above immediate implications of Bill 3190 impose significant system, operating and registration requirements to all business, especially those operating in multiple municipalities. Therefore, we recommend our clients to expedite the implementation process and not to wait for the Governor's signature of the bill.

Recent Tax Legislation



By Rafael A. Carazo

I. New Puerto Rico Sales and Use Tax exemption to Tugboats and Vessels Used for Bunkering

Act # 43, enacted on May 15, 2007, added section 2519 to the Puerto Rico Internal Revenue Code (the "Code"). Pursuant to that section, tugboats ("boats used for towing and pushing other boats") and vessels used for bunkering ("used

to fill other ships with coal or oil) are exempt from the payment of the Puerto Rico Sales and Use Tax (the "Sales Tax"), regardless of whether the services performed with those vessels are carried out within or without the territorial waters of Puerto Rico. This new exemption began on May 15, 2007.

II. Administrative Determination Clarifies the Applicability of the Puerto Rico Sales and Use Tax to Conventions Held in Puerto Rico

On April 5, 2007, the Puerto Rico Secretary of the Treasury issued the Administrative Determination Num. 07-04 (the "AD"), which provides guidelines as to the applicability of the Sales Tax to the various payments made or received by the sponsors ("organizadores") or

participants of a convention held in Puerto Rico.

According to the AD the sponsor of a convention is required to pay the Sales Tax on any admission fee applicable to the activities held in the convention such as green fees, tennis court fees, and fees for social activities.

On the other hand, the amount paid by the participants to the sponsors for the convention package does not constitute a taxable item ("partida tributable") for Sales Tax purposes and, therefore, is not subject to the Sales Tax. Furthermore, the amount received by the sponsors for the lease of space for exhibition booths or for promotion or advertisement are subject to the Sales Tax,

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Special Long-Term Capital... Continued from Page 2

with Act 42 of August 1, 2005 (hereinafter "Act 42") effectiveness clause. This case is pending of the Supreme Court decision.

The first possible interpretation is that the condition in the effectiveness clause of Act 40, requiring the approval of the Joint Resolution for the General Budget of fiscal 2006 dealt only with the length of the period during which the new rates were to apply (sunset provision of Act 40) and not with the effective date of such rates. Accordingly, since the Joint Resolution for the General Budget of fiscal year 2006 was not approved by the Governor the sunset provision never became effective. Consequently, the new preferential capital gain rates of 20% and

12.5% applicable to corporations and individuals respectively, should continue in force after June 30, 2007.

The second possible interpretation will depend, as previously said, on the final ruling of the Supreme Court in the class action case dealing with the effectiveness clause of Act 42. If the Supreme Court rules that Act 42 is a valid law even without the approval of the Joint Resolution previously mentioned, then the sunset provision of Act 40 became effective and the preferential capital gain rates enacted by Act 40 should not apply to any transaction effectuated after June 30, 2007. Since upon the enactment of Act 40 the old preferential capital gain rates were repealed, any capital gain recognized on transaction effectuated after June 30, 2007 should then be subject to the regular tax rates.

It is important to mention that there seems to be some tax consultants that believe that the cease of effectiveness of Act 40 will result in a long-term capital gain rate of 0%. That position should be very hard to support with the current language of the Code. The courts have determined that exclusions from income taxes should have a restrictive interpretation and that they must be clearly stated in the Code in order for them to be allowed. This seems not to be the case once Act 40 ceases to be effective.

Due to the above, due care should be exercised when entering into any transaction which may result in a recognizable long-term capital gain. However, it is necessary the approval of an amendment to the Code to correct this uncertainty and unintended negative possible outcome.

In a nutshell...

1. Act # 43 of 2007 added section 2519 to the Puerto Rico Internal Revenue Code related to tugboats and vessels used for bunkering .
2. Administrative Determination No. 07-04 issued by the Secretary of the Treasury provides guidelines as to the applicability of the Sales Tax to the various payments made or received by the sponsors or participants of a convention held in Puerto Rico.
3. Regulations No. 7221 issued by the Center for Collection of Municipal Revenues establish the administrative procedure that a taxpayer should follow when he/she does not agree with the assessment value of a real property, that was determined by the Center for real property tax purposes.
4. Treasury presented proposed regulations to incorporate to the Internal Revenue Code, the significant changes made by the Tax Justice Act to Section 1040D.

New Procedures for Representatives Resolving Tax Issues with the Puerto Rico Treasury Department

By Carlos González

In the past, representatives could go to Treasury any day at any time to discuss a tax issue, however they had no guarantee they would have the chance to meet with an officer after many hours waiting. In many cases the waiting time might be over 4 hours.

On June 12, 2007, the Puerto Rico Treasury Department issued Informative Bulletin of Internal Revenues No. 07-13 to

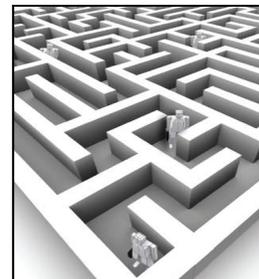
notify a new procedure to be followed in solving tax claims and issues. The new procedure provides for the representative to request, by phone or in person, a date and time for a meeting with a Treasury officer to discuss the case, present the evidence and resolve the issue. The Bureau of Taxpayer's Services Representative's Center (Office 211) in San Juan is the office most affected by this new procedure. With the new procedure, the representatives must request a date and time

for a meeting, which in our experience may be for as long as one week, however, it is almost certain that the case will be examined at that time.

In planning the visit to Treasury to discuss the case, it is important that we have and bring three things to the meeting:

1. Form 2745 – Power and Declaration of Representation – This form officially

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Recent Tax Legislation... Continued from Page 3

unless the transaction qualifies for the exemption applicable to services rendered by a "business to [a] business".

III. Recent Regulations Regarding the Administrative Procedure Available to Contest an Assessment made for Real Property Tax Purposes.

Following are some of the more relevant provisions of the Regulations:

1. only the person that is responsible for the payment of the real property tax has the standing to request an administrative review of the real property tax assessment notice (the "Notice");
2. a taxpayer who does not agree with the assessment value of a real property reflected in a Notice (the "Assessment Value") can contest it by filing a Petition for Administrative Review (the "Petition");
3. the Petition **must** be filed

within **30 calendar days from the date the Notice was mailed**; if not, the Petition will be **summarily dismissed**;

4. the Petition **must** be filed at:

(a) the **Center's Principal Office** if the objection to the Assessment Value relates to: (i) machinery and equipment classified as real property, or (ii) the applicability of a total or partial exemption to a real property, or

(b) at the **Center's Regional Office** corresponding to the municipality where the real property subject to the claim is located, if the objection is for any other reason; **if not properly filed**, the Petition will not be considered filed and will not stall the 30 days period mentioned in 3, above;

5. to commence a Review proceeding, the taxpayer **must pay**, at least, the total amount (**100%**) of the real property tax that he/she agree to, and forty percent (**40%**) of the real property tax that is being contested;

6. that payment must be made within the **30 calendar days** indicated in 3, above, and

7. a taxpayer that files a Petition will not be able to benefit from the discount for prompt payment unless he/she pays in full the tax due (instead of paying 40% of the real property tax that is being contested).

IV. Propose Regulations Amending the Current Regulations Dealing with the Credit for Purchase for export of Products Manufactured in Puerto Rico

On July 4, 2006, the Governor of Puerto Rico signed into law the Tax Justice Act of 2006. This Act is known for establishing the sales and use tax in Puerto Rico. However, it also amended several other provisions in the Puerto Rico Internal Revenue Code, including Section 1040D which provided for credits on the purchase of products manufactured in Puerto Rico which were exported.

Since the amendments made by the Tax Justice Act to Section 1040D of the Internal Revenue Code were significant, Treasury

presented proposed regulations to incorporate the changes made to the Internal Revenue Code. The proposed regulations amend the current regulations and provide guidance on the computation and use of the credits. Most of the changes were made to reflect the current statute which requires that the credit be applied first to the sales and use tax and then, if needed, to the income tax liability. Of particular significance are the following:

1. a request for administrative determination will need to be filed with Treasury requesting that the credit be granted and until such administrative determination is not issued no credit may be used against the sales and use tax;
2. No person will need to recognize income or loss on the transfer or receipt of the credit. This is important since probably for book purposes the company will need to record other income for the receipt of the credit.

Tuto Sanabria Awarded at MIDA Convention 2007

By Z&A Editorial Staff

Edgardo “Tuto” Sanabria, Partner at Zaragoza & Alvarado LLP, was honored with the Institution Service Special Award by the Chamber of Food Marketing, Industry and Distribution (MIDA), during its 2007 Convention.

Tuto, a former President of the Puerto Rico Society of Certified



for more than 15 years. During those years he has participated in several tax related projects, more recently helping MIDA with the proposal for an alternative method to document sales to resellers, to be in compliance with the Sales and Use Tax (IVU, by its Spanish acronym). In addition, Tuto worked in getting and IVU exemption from Treasury for materials related to conventions.

“Our team at Zaragoza & Alvarado feels very proud of Tuto on this achievement. This confirm what we at Z&A see every day: his professionalism and unparalleled sense of belonging and commitment with Puerto Rico”, said Juan Zaragoza, Partner and co-founder of the firm.

Public Accountants and former Assistant Secretary of the Treasury for Internal Revenues and Collections, has being involved with MIDA at different levels

New Procedures for Representatives...

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authorizes the representative to receive and inspect confidential information and to perform certain acts on behalf of the taxpayer;

- Copy of the tax return – ideally a copy of the tax return stamped by the PRTD as received;
- Evidences – may include cancelled checks, filing evidence, court orders, tax exemption decrees and other supporting documentation.

As an alternative, the tax issues can be discussed in any of the Taxpayer’s Services Centers in Bayamón, Caguas, Mayaguez and Ponce, or we may also send a written claim with the pertinent evidence by fax. Due to the complexity of the cases we take to the PRTD for resolution and due to the fact that it is recommendable to resolve tax cases in person because all questions can be made and answered at that meeting, we resolve most of our cases at the Bureau of Taxpayer’s Services Representative’s Center (Office 211) in San Juan.

Taxand Holds its Sixth Conference in Rome

By Z&A Editorial Staff

The 38 Taxand Firms met in Rome, Italy, on June 10, 11 and 12, 2007. This was the Sixth Taxand Conference and the four Partners of Zaragoza & Alvarado LLP participated in such event.

During the conference, the approximately 200 participants attended various technical sessions on current developments of interest to our clients in different countries. Also, the participants had the opportunity to meet with members of the different service lines (Business Development and Marketing, Knowledge Management, Real Estate, Reward Consulting and Transfer Pricing) as well as with several clients. Furthermore, one of the technical sessions dealt with a Global Update on Americas Tax Systems.

In addition, Zaragoza & Alvarado had an important role in

organizing a meeting of the Americas’ Taxand Firms. A marketing strategy was discussed during such meeting in order to continue expanding the services being provided to clients that operate within various jurisdictions of the Americas.

Juan A. Alvarado, co-founder and partners of Zaragoza & Alvarado LLP, remarks the outstanding growth of Taxand, a global tax network that spans 38 countries and groups 1,750 tax professionals, including 300 International Partners. “Every day we see that the Taxand Network is getting stronger and is rapidly becoming an important player in the marketplace. We are very proud of belonging to Taxand and being part of that success”.

Zaragoza & Alvarado LLP is the only member in Puerto Rico of the Taxand Global Network.

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Taxand

Taxand is the leading provider of completely independent tax consulting services, with more than 1,750 tax professionals, including 300 international partners in 38 countries.

Globalization and complexity impose deep expertise, specialization and flexibility. That is the reason why independent and specialized tax firms decided on February 9th 2005 to create Taxand, in order to serve local and international clients.

The Taxand Advantage

While Taxand is new to the industry, Taxand professionals are not. We bring deep knowledge, proven track records and decades of experience in tax services. One of the major advantages of Taxand is independence. We do not have independence conflicts which might threaten our objectivity or compromise the integrity of a client's operations or decisions.

We optimize clients' businesses by anticipating, measuring and managing tax implications of their day-to-day operations and strategic decisions.

Specialization is key. Business operations and global tax legislation are getting more and more complex. Deep tax expertise is needed to help clients identify, measure, and manage tax implications and risks within their operations. Our model is to specialize our people on Tax only and liaise with any other expertise (Legal, M&A, Finance, Risk Management, Technology...) whenever it is needed by clients.

Different from other international networks such as international law firms or big four firms, our core practice is tax, so every investment we make is in the tax practice rather than in other competencies that may seem more important to other firms.