Zaragoza Alvarado
Taxand

The Tax Advisor

Quarterly Newsletter

Volume 2, Issue 1 February 2008

Special points of interest:

- Act 197 Enacted
- New Legislation on Long-Term Capital Gains
- Moratorium for Internet Access Taxes Extended

Inside this issue:

Is Act 197 Making You Think of Buying a New Home?

By Edgardo Sanabria and César De Jesús

On December 14, 2007 Act 197 was enacted, once the Governor signed HR Bill Number 4117 to establish an income tax credit upon the acquisition of certain new and existing housing units acquired through a financial institution. Following is a discussion of the most relevant provisions of this Act.

There are three different transactions that may originate the new income tax credit pursuant to this Act. **Table I** shows each transaction and the amount of the tax credit that may be available. All these transactions must comply with certain requirements, before and after the acquisition of the housing unit, which should be performed by one or more of the sellers (i.e., developer, predesigned housing company or existing owner), the purchaser and the financial institution. It is also provided that to be eligible for the credit, the selling price of a newly constructed housing unit shall not exceed 225% of the limit provided by the Federal Housing Administration (FHA) for the municipality where the housing unit is located. Also, there are limits in terms of the maximum and minimum financing involved in the transactions. In essence, the mortgage note evidencing the debt with the lending financial institution can not, in any event, be higher than the selling price of the housing unit reduced by the income tax credit generated nor smaller than 225% of the income tax credit generated.

The most important requirement is the proper inclusion of the housing unit on the corresponding registry.

In the case of a newly constructed housing unit, such unit must be registered either by, its developer in the Registry of Newly Constructed Housing Units, or by the predesigned home sales company in the Registry of Approved Models. For an existing housing unit (which is limited to the first 1,500 units) it must be registered by its owner, through the financial institution, in the Registry of Existing Housing Units. The above registries are all kept and maintained up to date by the Department of Consumer Affairs ("DACO").

To request the income tax credit under this act, the financial institution must file, with the Treasury Department, the Request for Tax Credit upon the Acquisition of New and Existing Housing Units (Form SC 2855) and include, among

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Table I

Type of Transaction	Tax Credit
Acquisition of a newly constructed housing unit that will be used as a **principal residence** from: • a developer, or • a predesigned home sales company.	20% of the purchase price up to $25,000.
Acquisition of a newly constructed housing unit that will **NOT** be used as a **principal residence** from: • a developer, or • a predesigned home sales company.	15% of the purchase price up to $15,000.
Acquisition of an existing housing unit that will be used as a **principal residence.**	10% of the purchase price up to $10,000.

1998 Tax Incentives Act Will Now Expire on June 30, 2008

By Sandra Marie Torres

In a related article published in ***The Tax Advisor*** Fall 2007 Issue, we explained that as of the date the newsletter was released a Bill for the extension of the 1998 Tax Incentives Act ("1998 TIA") had not been approved nor a new Incentives Tax Act been issued before December 31, 2007. This together with the fact that Section 21 of the 1998 TIA stated that December 31, 2007 was the last date for filing applications for industrial tax exemption with the Office of Industrial Tax Exemption, had many entities filing either applications for new decrees or extension requests for their current decrees in time to meet the December 31st deadline.

Then on November 9, 2007, the Governor of Puerto Rico signed Act No. 168 which amends the above mentioned Section 21 to provide an "extended" deadline of June 30, 2008 to file applications before the Office of Industrial Tax Exemption.

As mentioned in previous newsletters, Section 8 of the 1998 TIA allows for the renegotiation, conversion or extension of current tax exemption grants and provides the requirements that must be satisfied under each option. In case of renegotiated decrees, this Section establishes a requirement of a 25% increase (based on a 3-yr average) on either the investment in machinery and equipment or employment level. Now, due to Act 168, entities will have additional

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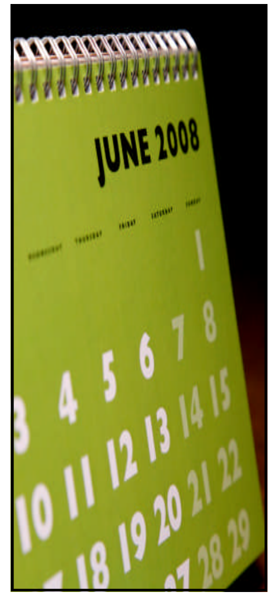

Is Act 197 Making You…
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other things; i) the number assigned to the housing unit on its registry, ii) copy of the sales deed, iii) copy of the mortgage deed, and iv) copy of the request for property tax exoneration, if applicable.

Once the completed request is filed, the Secretary of the Treasury will approve or deny the tax credit within the following fifteen (15) calendar days. If the Secretary does not take any action within the time prescribed, the tax credit will be considered automatically approved.

The approved income tax credit is available to the financial institution providing the funds for the acquisition in three installments as described in **Table 2**.

Don't do the math, and it's not a typo. The aggregated value of the tax credit granted in installments is greater than the income tax credit generated by the transaction, because the amount finally granted in installments takes into consideration the time value of money. Please be aware that the amount of the credit varies depending on whether or not the housing unit is used as a principal residence. If the housing unit is going to be used as a principal residence, the purchaser must use such unit as his/her principal residence for a period of at least three (3) years commencing after the acquisition. In the event that a purchaser ceases to use the housing unit as his/her principal residence he/she must pay a special additional tax equivalent to the original credit granted. The sales deed must include a clause to this effect.

The approved tax credit may be ceded, sold or otherwise transferred in whole or in part by the financial institution. If the income tax credit cannot be utilized by the financial institution, neither ceded, sold or transferred, a refund of the credit can be requested. The financial institution will earn interest on the refund requested if the same is not received within 30 days after the request is made, regardless of what is provided by the Puerto Rico Internal Revenue Code of 1994, as amended or by any other law providing for the payment of interest on refunds.

Table 2

Year	New Construction Principal Residence	New Construction Non Principal Residence	Existing Unit
1	The lower of $8,800 or 35.2% of the credit.	The lower of $5,200 or 34.67 of the credit.	The lower of $3,500 or 35% of the credit.
2	The lower of $9,200 or 36.8% of the credit.	The lower of $5,500 or 36.67% of the credit.	The lower of $3,600 or 36% of the credit.
3	The lower of $9,600 or 38.4% of the credit.	The lower of $5,800 or 38.67% of the credit.	The lower of $3,800 or 38% of the credit.

Sales and Use Tax Reduction Proposal

By Z&A Editorial Staff

On February 6th, the Governor of Puerto Rico, Hon. Anibal Acevedo Vilá, proposed, during its yearly State of the Commonwealth Speech, the reduction of the Sales and Use Tax from its current combined rate (State and Municipal) of 7% to 2.5%. In addition, he proposed to restore the general excise tax of 6.6%, but this time with limited exemptions. He indicated that shortly he will be submitting Legislation to that effect. However, immediately after the Speech, the Speaker of the House and the President of the Senate communicated their disagreement with the proposal.

New Legislation Reduces Long-Term Capital Gains Rate

By Rafael A. Carazo

Act No.181, enacted on December 10, 2007, amended various sections of the Puerto Rico Internal Revenue Code[1] related to the income tax and withholding tax rates applicable to long-term capital gains. The new rates apply to transactions carried out after June 30, 2007.

I. Long-Term Capital Gains Rates

The amendments reduced from 12.5% to 10% the long-term capital gains rate applicable to individuals, trusts and estates, and from 20% to 15% that applicable to corporations and partnerships.

The 10% rate also applies to a lump-sum payment from a qualified employee retirement plan with a trust organized in Puerto Rico (or outside Puerto Rico that has a trustee that is resident of Puerto Rico) that complies with certain investment requirements, because said payment is taxed as a long-term capital gain. However, lump-sum payments from trusts that do not comply with those requirements are subject to tax at a 20% rate.

II. Withholding Taxes

A. Individuals non residents of Puerto Rico - The withholding tax rate applicable to nonresidents who are U. S. citizens on the long-term capital gains from the sale of real property located in Puerto Rico was also reduced to 10% from 12.5%. On the other hand, when the seller is a nonresident alien the applicable rate was increased from a 12.5% to 25% .

B. Foreign corporations or partnerships not engaged in trade or business in Puerto Rico -_Act No. 181 did not change the withholding tax rates applicable to long-term capital gains derived by a foreign corporation or partnership not engaged in trade or business in Puerto Rico. Accordingly, the rate applicable in case of long-term capital gains derived from the sale of real property located in Puerto Rico or shares of stock remains at 25%. On the other hand, if the long-term capital gain is derived from the sale of any other type of asset the withholding tax is 29%.

[1] Sections 1012B, 1014(a), 1121(c), 1147(g), and 1165(d) of the Code.

In a nutshell…

1. *Amendments from Act No.181 reduced from 12.5% to 10% the long-term capital gains rate applicable to individuals, trusts and estates, and from 20% to 15% the one applicable to corporations and partnerships.*
2. *The withholding tax rate applicable to nonresidents who are U.S. citizens on the long-term capital gain from the sale of real properties located in Puerto Rico was also reduced to 10% from 12.5%. On the other hand, when the seller is a nonresident alien the applicable rate was increased from 12.5% to 25%.*
3. *Act No. 181 did not change the withholding tax rates applicable to long-term capital gains derived by a foreign corporation or partnership not engaged in trade or business in Puerto Rico.*

1998 Tax Incentives Act…
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time to file for a new grant, in case of new eligible operations, or for a renegotiation, conversion or extension in case or current decrees.

Furthermore, Act 168 includes an interesting provision that gives the House of Representatives until May 15, 2008 to approve a "Tax Incentives" Bill, May 25, 2008 as the deadline for the Senate to do the same, and May 31, 2008 as the deadline to send the Bill to the Governor for his signature. We will keep you posted in our next newsletters about any progress on this subject.

Puerto Rico Supreme Court Provides Rules Regarding the Procedure to Contest a Real Property Tax Notice

By Rafael A. Carazo

In June 2007, the Puerto Rico Supreme Court issued an opinion in *Villamil Development, S.E. v Centro de Recaudaciones de Ingresos Municipales*[1] in which it addressed an issue related to the compliance with the real property tax payment requirement imposed by Article 3.48 of the Municipal Property Tax Act whenever a taxpayer wishes to contest a real property tax notice.

In said case, the taxpayer, Villamil Development, S.E., received a Notice in connection with a real property that it owned. The Notice provided, among other information, the net taxable value of the property being taxed. Villamil Development, S.E. did not agree with the Value and decided to contest the Notice. To such effect, it filed a petition for review with the Municipal Revenue Collection Center (known in Spanish as the "CRIM"). Also, to satisfy the Tax Payment Villamil Development, S.E. paid an

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Moratorium for Internet Access Taxes is Extended for Seven Years

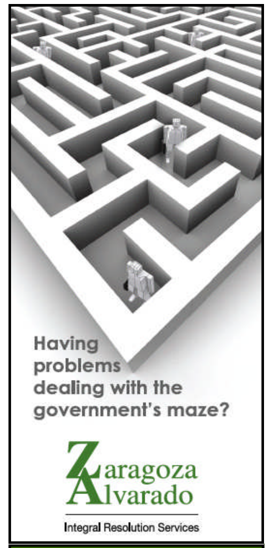
By Carlos R. González

With the approval of Public Law 110-108 on October 31, 2007, telecommunication companies that offer Internet Access Services and other bundled services that include Internet access should take a closer look to the covered services for purposes of the imposition of the sales and use tax ("SUT") provisions of the 1994 Puerto Rico Internal Revenue Code, as amended.

The U.S. Congress originally approved the Internet Tax Freedom Act ("ITFA") moratorium in 1998 which prohibited, for a three-year period, the imposition of state and local taxes on Internet Access. This moratorium was extended for an additional three-year period in 2001 and 2004, and was set to expire on November 1, 2007. On October 31, 2007, the 110th Congress approved an amendment to the ITFA, extending the moratorium for an additional period of seven years until November 1, 2014.

In addition to extending the moratorium, the ITFA modified the definition of Internet Access Services to include the purchase, use or sale of telecommunications by an Internet Service Provider ("ISP") to the extent it allows the users to access content, information, or other services offered over the Internet. The new definition also includes incidental services such as home pages, electronic mail, instant messaging, video clips, and personal electronic storage capacity, whether or not they are packaged with the service to access the Internet or sold separately.

From a local perspective, the moratorium provided by the ITFA is provided in the SUT provisions of the Code (Section 2301(mm)(2)(F) of the Code and Regulation Article 2301-1(mm)(2)(vi)). However, as a result of the expanded definition of Internet Access Services, there may be additional exempt services which were not originally considered as such by telecommunication companies when the SUT provisions of the Code were enacted in 2006. We recommend a review of all your telecommunication products and services, whether they are sold separately or bundled with others, to ascertain whether the Internet Access Services exclusion is being properly applied.



Puerto Rico Supreme…
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amount equal to the total amount of tax due for the first semester of the fiscal year[2] for which the Notice was issued[3], less the 10% discount allowed by Article 3.43 of the Act for the prompt payment of the tax.

The CRIM denied the Petition; it understood that Villamil Development, S.E. did not comply with the Tax Payment and since the requirements of Article 3.48 are of jurisdictional nature, it could not entertain it. According to the CRIM, the Tax Payment must be equal to: (1) the amount of the annual tax imposed to which the taxpayer agrees, plus 40% of the remaining amount; or (2) the total annual tax imposed. Thus, the payment made by Villamil in the amount of the tax due for one semester less the Discount, did not satisfy that requirement.

Presented with the issue, the Supreme Court agreed with the CRIM's interpretation of the statute and concluded that: (1) the Tax Payment under both alternatives provided by Article 3.48 must be calculated on the basis of the annual tax (the tax due for the fiscal year), and (2) in order to benefit from the Discount, the taxpayer must pay the annual tax due.

Based on the above, the Court concluded that since Villamil Development, S.E. did not pay the annual tax due: (1) it did not comply with the Tax Payment, nor (2) could apply the Discount to the payment made. Therefore, it failed to meet the requirements of Article 3.48 and the CRIM acted properly dismissing the Petition.

[1] 2007 TSPR 102.
[2] The fiscal year commences on July 1st and ends on June 30 of the next year.
[3] Article 3.41 of the Act allows that the tax due for the fiscal year (the annual tax) be paid in two installments due on July 1st of one year and January 1st of the next year.

News from Puerto Rico Treasury

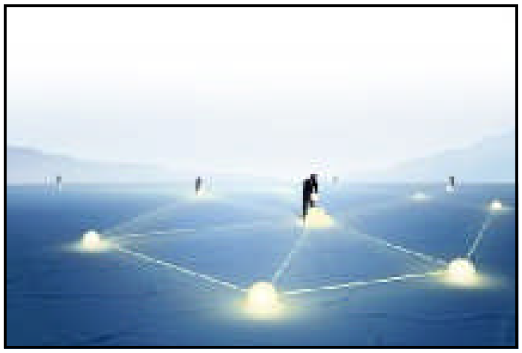
By Juan González

The Governor of Puerto Rico, Hon. Anibal Acevedo Vilá, announced the appointment of CPA José G. Dávila Matos as new Secretary of Treasury, substituting Juan Carlos Méndez effective January 2, 2008. Dávila, who is a former President of the Puerto Rico Society of Certified Public Accountants, occupied the Directorship of the Office of Management and Budget before being appointed to Treasury.

Other movements in Treasury include the following appointments:

- William Díaz Natal - Deputy Secretary of Treasury
- Víctor Aledo - Assistant Secretary for Internal Revenue
- Andrés Fortuna - Deputy Assistant Secretary for Internal Revenue.

Taxand Members Named Top-Tier Firms by World Tax 2007



By Taxand Editorial Staff

In its annual World Tax 2007 survey, the comprehensive guide to the world's leading tax firms and tax advisers, *International Tax Review*, yet again named various Taxand member firms among the world's leading tax firms in the 41 most important economies.

This year, the survey covered 35 Taxand locations around the world. Four Taxand member firms were ranked **Tier 1** (the highest level) in their corresponding markets surveyed, namely, *Bech-Bruun* from Denmark, *Zepos & Yannopoulos* from Greece, *Garrigues Portugal* and *Garrigues Spain.*

In addition, numerous other Taxand member firms were also ranked **Tier 2**, **3**, **4** and **5** in 20 locations, such as the following: **Tier 2** – *Shaddick & Spence* from Australia, *Gómez-Pinzón Abogados* from Colombia, *BMR & Associates* from India, *Fantozzi & Associati* from Italy, *Atoz* from Luxembourg, *Pepeliaev, Goltsblat & Partners* from Russia, and *Tax Partner* from Switzerland; **Tier 3** – *Bruchou, Fernandez Madero & Lombardi* from Argentina, *Hendersen Taxand* from China, *Borenius & Kemppinen* from Finland, *Arsene Taxand* from France, *Avanzia Tax Advisors* from Malta, *Selmer* from Norway, *Skeppsbron Skatt* from Sweden, and *Candal Taxand* from Venezuela; **Tier 4** – *Barbosa, Müssnich & Aragão* from Brazil, *Mijares, Angoitia, Cortés y Fuentes* from Mexico, and *Alvarez & Marsal Taxand* from the United States; **Tier 5** – *Gowling Lafleur Henderson* from Canada and *Accreo Taxand* from Poland.

World Tax 2007 is an authoritative publication for all companies or professionals needing expert advice from tax advisors and lawyers. In this year's survey, World Tax 2007 analyzed nearly 3,000 interviews with corporate tax directors and tax advisers. *International Tax Review*'s declared objective of interviewing both advisors and tax executives was to get an opinion of tax advisers, not just from their clients but also from their peers, and this is what makes Taxand's achievements in 2007 all the more remarkable.

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Mauritius, Mexico, Netherlands
New Zealand, Norway, Pakistan
Peru, Philippines, Poland
Portugal, Puerto Rico, Romania
Russia, Spain, Sweden
Switzerland, Turkey, UK
USA, Venezuela

Seventh Taxand Conference Held in New Delhi, India

By Taxand Editorial Staff

On 5, 6, 7 December 2007, the Taxand firms met in New Delhi, India, for the Seventh Taxand Conference. Zaragoza & Alvarado was there represented by Partners Juan Zaragoza and Sandra Marie Torres.

In addition to participating in numerous technical sessions on current developments of interest to our clients in different jurisdictions, participants had the opportunity to meet members of different service lines (Real Estate, VAT, Transfer Pricing, Indirect Taxes, Transaction Advisory and Private Equity and Knowledge Management) during the Conference. We had also the opportunity to attend very interesting sessions with guest speakers, as the Minister of State for Finance, a Chairperson of the National Human Rights Commission, the Managing Director of IMA, the former Chief Justice of India, or the Additional Solicitor General of the India Government.

Our wholehearted thanks go to BMR for hosting and organizing this extremely successful and exciting event. The next Taxand Conference will take place in Maastricht in June 2008.

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Zaragoza & Alvarado LLP is a Limited Liability Partnership organized under the laws of Puerto Rico and is engaged in providing tax and business advisory services. We are the first truly multidisciplinary tax and business advisory professional services firm in Puerto Rico, unencumbered by the constraints of association with an auditing firm, and the regulatory and disclosure rules of the Securities and Exchange Commission.

Backed up by years of unmatched hands-on experience in public accounting, government and corporate tax, our team of tax consultants is redefining the market by providing professional tax and business advisory services through its "top-heavy" structure, designed specifically to provide high level tax consulting to our clients on a more personalized basis.

Zaragoza & Alvarado LLP is a proud member of Taxand, the leading provider of completely independent tax consulting services.

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Taxand

Taxand is the leading provider of completely independent tax consulting services, with nearly 2,000 tax professionals, including 300 international partners in 41 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.

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