

Special points of interest:

- Fiscal Emergency Act Enacted
- Relevant Provisions of Fiscal Emergency Act

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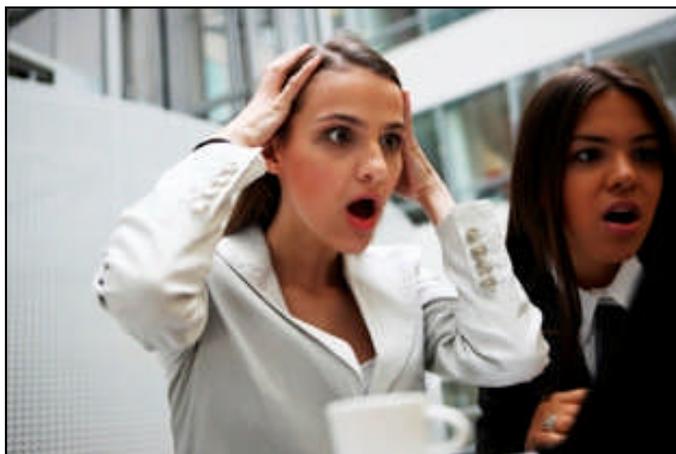
March 2009

New Fiscal Emergency Act: The Price of Recovery

By Juan Zaragoza

The Honorable Governor of Puerto Rico, Luis Fortuño, signed into law on March 9, 2009 the “Special Act declaring a state of fiscal emergency and establishing an integrated fiscal stabilization plan to save Puerto Rico’s credit” (the “Act”). The Act is just one of several laws intended to reduce the government’s expenses, principally its payroll costs and increase tax collections.

The Act amends, either on a permanent or temporary basis, several tax provisions with the main purpose of increasing tax collections. The taxes affected are income, real property, excise and sales and use. In addition the Act provides a moratorium on the issuance and use of certain tax credits allowed under special legislation and subjects to a special tax certain entities previously exempt from taxes such as savings and loans cooperatives.



The amendments affecting individuals are mainly targeted to high income individuals whose income is composed of several types of exempt income and income subject to preferential tax rates. In the corporate tax side there are amendments affecting both the tax rate structure and the allowable deductions.

As of the date of this newsletter there is no clear estimate of the

revenue to be generated from these amendments nor it is possible to determine the short and long term effect they will have on the Island’s economic development. It all will depend on the use given by the government to the increased tax revenues. For those taxpayers affected their only hope is that these measures will ignite the Island’s recovery process.

Puerto Rico Moves Away from the Sales Tax System

By Juan Zaragoza

The Sales and Use Tax (the “SUT”) provisions of the 1994 Puerto Rico Internal Revenue Code, as amended (“The Code”), have been in place at the state level since November 2006 and at the municipal level

since July 2006. The system provides for the typical reseller exemption, which subject to certain documentation requirements, allows goods to flow through the distribution chain without the imposition of any tax.

The Act amended the SUT pro-

visions of the Code to eliminate the reseller’s exemption effective April 1, 2009. Accordingly, goods will be subject to tax at every step of the distribution chain; however each reseller will be allowed to claim a credit for the taxes paid on its

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Puerto Rico Moves Away...
Continued from Page 1

purchases. In essence, each party in the chain will end up remitting to Treasury the tax corresponding to the value they added to the goods being sold (including obviously their mark up). It remains to be determined how will merchants who sell most or all of their goods to exempt persons, such as the government will be able to recover the tax paid on their purchases since they will not collect any tax on their sales.

The Act, on the other hand, didn't amend the inventory exception of the use tax provisions, which allows importers to store their inventory free of tax. Accordingly this creates an uneven treatment for importers—retailers who purchase their goods locally and will have to pay the tax, versus those that import goods who will be able to purchase and store their inventory free of tax.

An interesting side effect of this amendment is the redistribution of the tax collections among municipalities.

Finally the due date for the filing of the SUT return and the corresponding remittance is being changed from the 20th to the 10th of every month. This will place increased pressure on merchants to have the necessary information available to file the return in half of the time previously allowed.

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Corporate Taxation Changes Affecting Certain Financial Institutions

By Edgardo Sanabria

The Act introduced various amendments to certain Puerto Rico laws, to impose special income taxes to certain financial institutions that prior to these amendments were not subject to income tax or only partially subject to it. In addition, it also amended Act 197 of December 14, 2007 which was enacted to promote the purchase of newly constructed housing by granting certain income tax credits.

Income Tax Temporary Provisions

-Amendment to the Provisions of the Tax Credits Program for the Purchase of Newly Constructed Housing

The Act amended the provision of the Code, which allowed every Financial Institution participating in the program to claim a refundable tax credit for any tax credit not used, as of the close of any taxable year commencing after December 31, 2007 as long as the same has not been assigned, sold or transferred. Two amendments were made; one was to postpone the time and the way to claim the refund and the second was to deny the payment of interest on the refund, irrespective of when the refund is finally paid by the Department of the Treasury to the Financial Institution.

Pursuant to the amended provision, the participating Financial Institution will be allowed to claim a refundable tax credit for any unused tax credit for each of the three taxable years commencing after December 31, 2010.

-Income Taxation of Insurance Cooperatives

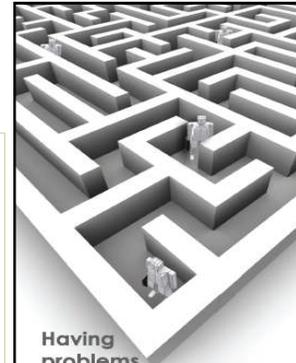
Pursuant to the provisions (Article 34.180) of Chapter 34 of the Puerto Rico Insurance Code, insurance cooperatives organized under the same, being non-profit associations are not subject to the payment of income tax. However, the Act amended such provision to impose a special tax of 5% on the amount of taxable income in excess of \$250,000 during any taxable year commencing after December 31, 2008 and prior to January 1, 2012.

In addition, it is further provided that the taxable income shall be determined pursuant to the provisions of Subchapter G of the Code dealing with Insurance Companies.

-Income Taxation of Credit Unions

Pursuant to the provisions (Article 6.08) Chapter VI of the Cooperative Savings and Credit Associations Act of 2002 (Act 255) credit unions organized under Act 255 are not subject to the payment of income taxes. The Act amended such provision to impose a special tax of 5% on the amount of taxable income in excess of \$250,000 during any taxable year commencing after December 31, 2008 and prior to January 1, 2012. It is important to mention, however, that Article 72 of the Act provides for the effective date for the application of its provisions, including specific dates for the effectiveness of certain Articles. In that regard, Article 72 establishes that the provisions imposing the 5% special tax to Credit

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"This [preparing my tax return] is too difficult for a mathematician. It takes a philosopher."

Albert Einstein

**Corporate Taxation...
Continued from Page 2**

Unions will be effective commencing on July 1, 2009.

Accordingly, only Credit Unions with taxable years commencing on or after July 1, 2009 will be subject to the newly enacted 5% special tax for the entire three year temporary period. Those Credit Unions with taxable years commencing after December 31, 2008 and prior to July 1, 2009 will be subject to the newly enacted 5% special tax for a period shorter than three years as they will enjoy a grace period that may range from one month and six months depending on when after December 31, 2008 their taxable year begins. This appears to be an unintended result.

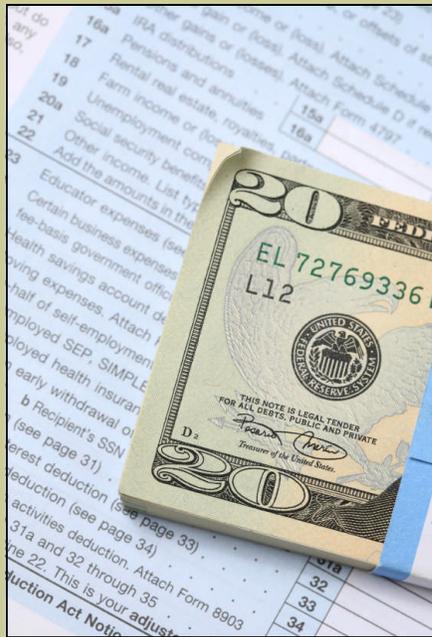
It is important to mention that the cooperatives created under the provisions of Act 239 of September 1 2004, known as the General Cooperative Act of 2004, will not be subject to the 5% special income tax since no amendment was made to the act.

-Income Taxation of the Cooperative Bank of Puerto Rico

Article 16 of the organic Act (Act 88 of June 21, 1966) creating the Cooperative Bank of Puerto Rico (Bank) provides that it is exempt from taxes, including income taxes. The Act, however, amended such provision to impose to the Bank a 5% special tax on the amount of taxable income in excess of \$250,000 during any taxable year commencing after December 31, 2008 and prior

to January 1, 2012.
-Income Taxation of International Banking Entities (IBE)

Except for the amendment made by Act Number 13 of January 8, 2004 to Section 25 of the International Banking Center Act, IBE's were, in general exempted from income taxes.



As a result of such amendment, any IBE operating as a unit (branch) of a bank organized under the Banking Law of Puerto Rico deriving net income, determined under the provisions of Subchapter B of Subtitle A of the Code, in excess of 20% of the bank total net income became subject to income tax under Subtitle A of the Code on such excess. The Act, amended again Section 25 of the International Banking Center Act to impose a 5% special tax on the net income, determined under the provisions of Subchapter B of Subtitle A of the Code, of all the other IBE's during any of the taxable years commencing after December 31, 2008 and prior

to January 1, 2012. In addition, the new amendment also imposes the 5% special tax on the safe harbor net income of all IBE's operating as units.

It is important to mention, that those IBE's operating as units and already paying income tax under Subtitle A of the Code on the net income in excess of the safe harbor will also be subject to the 5% surcharge tax that will be imposed on the tax determined on such excess as a result of another amendment introduced by the Act.

-Income Taxation of International Insurers and Reinsurers

The Act also amended Article 61.240 of the Puerto Rico Insurance Code to impose a 5% special tax on the net income of every International Insurer or International Insurer Holding Company during each of the taxable years commencing after December 31, 2008 and prior to January 1, 2012. Such net income shall be determined pursuant to the provisions of Subtitle A of the Code. Prior to this amendment, those entities were totally exempted from income and other taxes with the objective of developing the Island as an International Insurance Center.

The amendment also imposes a filing requirement to those entities throughout the temporary period, since prior to the amendment these entities were not required to file an income tax return.

**Zaragoza
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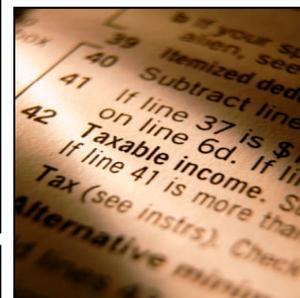
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Income Taxes - Changes Affecting Individuals and Corporate Taxpayers

By Felipe Mariani

For those of you that waited for that special event in your life to look at your tax planning, we unfortunately inform you that such time has arrived. The income tax provisions of The Act will impact a significant number of individuals and corporations by changing some of the most important rules in the game. If you are one of those individuals with a tax planning based on tax-free or preferential tax investments take a close look, that tax planning may not be so attractive now. Those special partnerships using the completed contract method may very well be in deep waters if they do not react swiftly. Corporations with management fees, technical support, and a significant amount of services received from outside of Puerto Rico, may not be able to claim deductions for them. And everyone else, hold on tightly that the 5% surcharge has arrived.

In the following paragraphs we will summarize the income tax provisions of the Act, let you know if they are permanent or temporary, and raise issues that you may need to look at.

Permanent Provisions

Alternative Minimum Tax on Individuals

Previous to the signing of the Act, the alternative minimum tax on individuals had as its purpose the imposition of a minimum tax on those individuals which had a high proportion of deductions to adjusted gross income. The Act changed such purpose and now the alternative minimum tax on individuals is imposed to those individuals with a significant

amount of excluded or exempt income. This change will require a review of the investment strategy of those individuals which tax and investment planning relied on tax-free investments to make sure that the alternative minimum tax does not have a significant effect on their return on investment. It may also have a significant impact on all those taxpayers who have substantial amounts of income subject to preferential tax rates (dividends, interests and capital gain, among others).

The Act provides that the taxpayer will be subject to the alternative minimum tax on the "alternative minimum tax net income". The alternative minimum tax net income is computed by adding to the net income of the taxpayer (gross income less deductions) a significant number of the exclusions provided by the Code, and all the exclusions and exemptions provided by other laws. The excluded income which will be part of the alternative minimum tax net income includes all the income subject to special tax rates (interests, dividends and capital gains), rental from historical districts, pension exclusions, among others.

The Act also requires, for purposes of the alternative minimum tax net income, that the share of gain or losses of a partner in a special partnership be computed using the percentage of completion method instead of the completed contract method. This amendment will probably require



special partnerships to provide an informative declaration for purposes of the regular income tax (using the Completed Contract Method) and a separate informative declaration for the alternative minimum tax (using the Percentage of Completion Method). Also, this amendment will require quantifying the consequences to the special partnership's partners of using the percentage of completion for purpose of their alternative minimum tax net income. If such change in method triggers an alternative minimum tax to the partners, the benefits provided by the use of the completed contract reduces significantly and the special partnership and its partners should revise their tax and structure planning.

In addition, the Act limits the mortgage interest deduction for purposes of the alternative minimum tax income computation to 30% of the adjusted gross income of the taxpayer computed by adding the

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"The income tax provisions of the Act will impact a significant number of individuals and corporations by changing some of the most important rules in the game. If you are one of those individuals with a tax planning based on tax-free or preferential tax investments take a close look, that tax planning may not be so attractive now."



**Income Tax—Changes...
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excluded income used to increase the alternative minimum tax net income. We have identified the following issues that have not been addressed by the Act and which may have an impact in the filing of tax returns:

1. The sections of the the Code providing preferential tax rates provide that no additional tax will be imposed on the income subject to the special tax rate. Those sections were not amended by the Act, therefore, it is questionable whether the alternative minimum tax may be imposed on such income.
2. The section of the Code which provide the filing requirements for individuals has not been amended; therefore, a taxpayer which is not required to file an income tax return may not be subject to alternative minimum tax.
3. In the particular case of the dividends from entities with a tax exemption grant, which are income exempted from taxation by law, it is not clear whether the Act may require such income to be included in the alternative minimum tax, especially on those cases where the government and the taxpayer have signed a contract (i.e., tax incentive grant).

Gradual Adjustment on Individuals

The Act increased the maximum gradual adjustments for individuals to \$8,490 plus 33% of the personal exemption and

dependents deduction. In the case of those taxpayers filing under the status of married filing separately, the adjustment increased to \$4,245 plus 33% of the personal exemption and the dependents deduction. With this increase, the Act establishes a maximum tax rate for individuals of 33% plus any increase due to the limitation of the personal exemption and the dependent deduction.

Credit for the Purchase of Products Manufactured in Puerto Rico for Export

The Code provides a credit for the purchase of products manufactured in Puerto Rico when the taxpayer or a related entity exports products manufactured in Puerto Rico. Since July 2006, such credit was applied first to the sales and use tax payments and, subsequently, if any credit was still available, to the income tax liability. The Act amended the Code to allow the use of the credit only against the income tax liability. The Act did not amend the provisions regarding the limitation on the use of the credit and its carry-forward.

Temporary Provisions

Adjustments in Computing the Alternative Minimum Net Income

The Act added a new adjustment to the computation of the alternative minimum net income for corporations or partnerships. For the years beginning after December 31, 2008 and before January 1, 2012, corporate or partnership taxpayers will be required to add to their alternative minimum net income the deductions related to expenses accrued or paid for professional services rendered outside of Puerto Rico, which were not subject to income tax withholding. Since, services rendered outside of

Puerto Rico are not subject to Puerto Rico income tax withholding and, therefore, all of such services will have to be added back as part of the alternative minimum net income. The term services will include those provided by a related party (say parent entity), as well as an unrelated service provider. If such is the case, corporations may suffer a significant impact from the inclusion of management and technical fees as part of the alternative minimum net income.

Imposition of Surcharge

The Act establishes a 5% special surcharge over the total tax liability of all corporations, partnerships, estate, trusts and individuals with an adjusted gross income of more than \$100,000. In the case of married individuals living together and filing a joint return, the 5% special surcharge is applicable when their adjusted gross income is \$150,000. Since the special surcharge is applied over the total tax liability (total tax liability x 5%) the maximum increase of the effective tax rate of the taxpayer will be 1.95% for corporations and partnerships (39% x 5%) and 1.65% for individuals (33% x 5%).

The total tax liability will include the regular tax, the surtax, the gradual adjustments, the alternative minimum tax and the other special taxes provided by the Code (interest, dividends and capital gains, among others). In addition, the credits which may be used to reduce the special surcharge will be limited to the foreign tax credit, prior year over payments and income tax withholdings.

Excise Taxes Changes

By Juan Alvarado

Cigarettes

The Act increases the excise tax on cigarettes from \$6.15 to \$11.15 per each 100 cigarettes or fraction thereof. It should be noted that the term "cigarettes" will exclude the cigars or artisans' hand-made cigarettes as defined by the Secretary of the Treasury in the Regulations. No Floor Tax was imposed on cigarettes already in inventory.

Motorcycles

The motorcycles are now subject to excise tax as automobiles. Since the automobiles are not subject to sales and use tax, then the motorcycles will be excluded for sales and use tax purposes. No Floor Tax was imposed on the motorcycles already in inventory

Alcoholic Beverages

The taxes on wines, champagne and sparkling wines as well as beers are increased by the Act. The tax on beer that is subject to the special exemption based on gallons produced was also increased. A Floor Tax was imposed for those products already in inventory.

Tax Credits Moratorium

The Act provides a moratorium on the use of certain tax credits for each of the taxable years commenced after December 31, 2008 and before January 1, 2012. That is, the following tax credits cannot be used during such taxable years to reduce any of the taxes imposed by the Code:

1. Purchase of Products Manufactured in Puerto

Rico for local sale and consumption (Code Section 1040E)

2. Solid Waste
3. Venture Capital Funds
4. Theatrical District
5. Conservation easements
6. Revitalization of Urban



7. New Construction on Rehabilitation of Social Interest Housing
8. Investment on Housing Infrastructure

As you can see, tax credits generated in manufacturing operations, tourism activities, cinematographic projects as well as other tax credits included in the Code (other than Code Section 1040E) are not subject to the moratorium.

The moratorium does not apply to any natural or juridical person that, before March 4, 2009, had bought the tax credits subject to the moratorium from the person to whom the tax credits were granted. Upon request by the Secretary of the Treasury, such person shall show evidence of the date the tax credits were acquired.

Any expiration term or period established to claim the tax credits subject to the moratorium will be suspended during the period of the moratorium

and will start to run again from January 1, 2012 on.

It is of utmost importance that owners of tax credits that were subject to the moratorium file with the Secretary of Treasury an informative return on or before May 30, 2009 (the "Informative Return").

This informative return is indispensable for the owner of such tax credits to claim them for taxable years commencing on or after January 1, 2012. The informative return should be signed under penalties of perjury and in the form prescribed by Regulations issued by the Secretary of the Treasury.

In addition to the moratorium on the use of the tax credits mentioned above, the Act provides a moratorium on the granting of such tax credits. Also, no agency, public corporation, instrumentality, municipality or dependency of the Commonwealth of Puerto Rico can evaluate, carry through, grant nor issue any tax credit or authorize any project or transaction that results or could result in the generation of tax credits subject to the moratorium. This restriction is very broad and basically puts a "hold" on the tax credit applications that are in process at the different governmental agencies.

Finally, the Secretary of the Treasury must establish a Registry of Tax Credits before December 1, 2009 where it includes all the information gathered with the Informative Returns. He also must carry out a detailed analysis of all legislation that grants tax credits in order to determine its effect on the government's revenue collections and its effectiveness in generating economic activity, and submit a report with recommendations to the Legislative Assembly.



"Also, no agency, public corporation, instrumentality, municipality or dependency of the Commonwealth of Puerto Rico can evaluate, carry through, grant nor issue any tax credit or authorize any project or transaction that results or could result in the generation of tax credits subject to the moratorium. This restriction is very broad and basically puts a "hold" on the tax credit applications that are in process at the different governmental agencies."

Fiscal Emergency Act Amendments on Property Taxes

By Sandra Marie Torres

The Act amends various sections of the 1994 Puerto Rico Internal Revenue Code, as amended (“The Code”), and the Municipal Property Tax Act of 1991, as amended (the “1991 PTA”), as well. We summarize below those that we understand will have a major impact upon taxpayers (for both individuals and non individual taxpayers). Bear in mind that this Act is subject to the issuance of regulations that may explain the mechanism of applying these amendments. However, as we will highlight in “Z&A comments” we understand that there are various items not addressed by these amendments for which we have already raised questions.

100% Addition to current property taxes paid on real property used for “residential purposes”

For fiscal years 2009-2010 through 2012-2013 (inclusive) there will be a special tax on all real property used for residential purposes in the amount of one hundred percent (100%) of the amount assessed and determined by the Municipal Revenue Collection Center (“CRIM” for its Spanish acronym) upon such real property. For these purposes, the assessed value would be that determined under the provisions of the 1991 PTA after taking into consideration the exemptions provided by Articles 2.02 y 2.03 of such act and Article 4 of Act No. 203 of December 14, 2007, as amended, but without taking into consideration any discount for payments made before 30 days or 60 days from their due dates (discounts provided by Article 3.43 of the 1991 PTA). This special real property tax

will be in addition to any other tax assessed by any other existing law. This tax will be paid to the Secretary of the Treasury in two installments due on September 1st and March 1st of each year. There will be interest and surcharges added if the amount is not paid 90 days after its due date. However, note that these payments are subject to discounts of 10% and 5% if paid within 30 days or 60 days after their due date, respectively. The Secretary of the Treasury will issue by mail a notice to each taxpayer with the assessment of the special property tax on real property used for residential purposes.

On the other hand, the municipalities are prohibited to approve any increase to the real property tax rate in effect as of January 1st, 2009.

Z&A comments: even though the Act provides a definition of the term “residential purposes,” at this time we understand that it is not clear if this special tax applies to real property taxes paid on second homes and on real property used in the taxpayer’s rental business that is used by the lessee for residential purposes.

Real property assessment applicable to all kind of taxpayers

For fiscal years 2009-2010 through 2012-2013 (inclusive) it appears that a new assessment on all real property will take place. Note that when we state that it “appears” it is because the current assessed value established by the CRIM must be multiplied by 10 (as well as the exemptions and exonerations) to arrive at the “new assessed value”. However, the maximum allowed real property tax rates are



divided by 10 leaving the “calculated tax” identical as under the current law.

Z&A comments: This Act also amends Article 3.02 of the 1991 PTA which is the one that authorizes a new appraisal of property in Puerto Rico, provided certain requirements are met (among them that the CRIM’s Governing Board resolution ordering the new appraisal must be approved by the unanimous vote of all the Mayors who are members of the Governing Board and ratified by the Secretary of the Treasury) shall not be applicable with respect to the real property assessment as of January 1st 2009, 2010, 2011 and 2012. This language seems to imply that the current assessment multiplied by 10 mentioned above may be eliminated in the future, therefore, allowing for a new appraisal of property in the near future.

Real and personal property tax exemptions to Cooperative Insurance Companies

Subject to certain requirements, these taxpayers will be subject to a total personal and real property tax exemption that may not exceed an assessed value of \$1,000,000.

“Even though the Act provides a definition of the term “residential purposes,” at this time we understand that it is not clear if this special tax applies to real property taxes paid on second homes and on real property used in the taxpayer’s rental business that is used by the lessee for residential purposes.”



Taxand 2009 Global Conference - Cash is King

By Taxand Editorial Staff

In his keynote speech at the Taxand 2009 Global Conference, Tony Alvarez advised delegates that in the current economic climate, "Cash Is King". This perspective was a recurring theme as Taxanders from around the world presented a global view of the key tax issues facing multinational clients today and in the future.

Hosted by Alvarez and Marsal Taxand LLC, Taxand's US member, this year's Taxand Global Conference took place at The Westin Diplomat Hotel in Miami, Florida from the 18th to the 20th February. Over 200 Taxand delegates attended alongside more than 60 global Taxand clients to deliver and contribute to a wealth of sessions focused on making the most of the economic downturn.

Key pointers from the conference included how to:

- help our clients generate more cash by managing tax effective supply chain management
- leverage sophisticated advice to deliver tax efficient operations
- prepare for the impact of the OECD business restructuring paper
- structure acquisitions in a cash efficient manner
- identify refund opportunities
- realize value from depreciating real estate through distressed asset investment or divestment
- organize the model tax department of the future
- restructure the debt of

your global operations

- leverage from changes anticipated in the tax audit arena
- achieve global tax efficiencies through benefiting from new contract manufacturing regulations

Anecdotes, case studies and surveys carried out across Taxand's 47 member countries were also shared to help clients picture how to apply Taxand's experience to their businesses. All of the materials are downloadable here.

Representatives from the International Tax Review, an influential Euromoney publication, also attended the

event to present three new-comer awards given in 2008, recognizing the quality of



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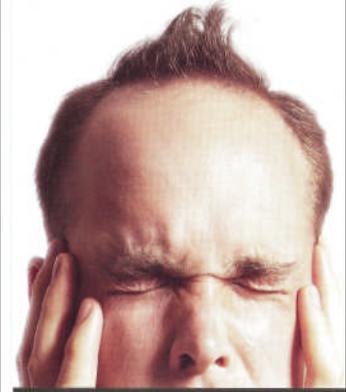
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The best things in life are free, but sooner or later the government will find a way to tax them.

Author Unknown

Wondering
how to
achieve
operational efficiency
and
financial stability
while
controlling
your

overhead...aches?



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