

Tax Insights: New phrases have become common in Puerto Rico's day to day vocabulary

Economic Development | Re- start the economy | Incentives for job creation | Attract new capital – new investment | Fiscal crisis | Unpayable public debt | Tax reform | Value Added Tax | Uncertainty | Fiscal Control Board | Moratorium

These are some of the phrases that are now common in our day to day vocabulary. All of the sudden, everybody in Puerto Rico is an expert in economics and on what we need to be doing to re-start our economy in order to survive the current fiscal crisis.

In this article we will not provide the solutions to these questions, but we will, at least, provide you some ideas to keep in mind when trying to arrive to the solutions to our current crisis as a country, territory or whatever term you will like to use. One thing is true; we are people that share a lot (culture, location, etc.) and that need to find a solution together.

What is economic development?

“No single definition incorporates all of the different strands of economic development. Typically, economic development can be described in terms of objectives. These are most commonly described as the creation of jobs and wealth, and the improvement of quality of life. Economic development can also be described as a process that influences growth and restructuring of an economy to enhance the economic well-being of a

community. The main goal of economic development is improving the economic well-being of a community through efforts that entail job creation, job retention, tax base enhancements and quality of life.¹

There are many elements to take into consideration when deciding on the policies and programs the government will put in place in order to spark economic development. One of these: business climate.

Key factors used in the measure of business climate include²:

- * Business and income tax levels
- * Workforce availability
- * Energy costs
- * Market size
- * Quality of services
- * Cost of living
- * Quality of life
- * Environmental regulation
- * Permitting, licensing, and various reporting regulations
- * Real estate costs and availability
- * Infrastructure
- * Access to financing and capital
- * Incentive

Business owners and investors also need certainty. They need to be assured that the game rules will be the ones promised and are not changed in the “middle of the game”.



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¹ The International Economic Development Council's Economic Development Reference Guide

² Idem

Government actions can increase or decrease confidence and trust on the system, therefore, changes must be assessed carefully in order to reduce any negative impact or generation of uncertainty.

As mentioned above, tax laws are essential part of the business climate. Tax reform and changes are a favorite topic of all governments, and often they are perceived as the way to attract or retain new businesses to a location. Puerto Rico is not the exception, especially in the last years. Unfortunately, the changes that have been approved lately are far from creating a welcoming business climate. Let's take for example the road to the adoption of the Value Added Tax ("VAT").

- House of Representatives Bill No. 2329 ("Bill 2329") was filed on February 11, 2015 – VAT of 16% was expected to become effective on January 1, 2016 along with important changes to both individuals and businesses income tax. This Bill received opposition from all sectors of the business community as well as civil opposition.
- Substitute Bill 2329 filed on April 29, 2015 – Contribution to Goods and Services, better known by its Spanish acronym as "COBYS" of 13% was expected to become effective on January 1, 2016 with no important income tax changes. This Bill was "killed" on April 30, 2015.
- House of Representatives Bill 2482 was filed on May 18, 2015 and approved on May 29, 2015, enacted as Act 72-2015 – VAT of 10.5% expected to become effective on April 1, 2016. Two intermediate changes to Sales and Use tax included as well as no income tax relief.

- On March 8, 2016, the Puerto Rico Treasury Department issued Administrative Determination 16-04 postponing the effectiveness of the VAT of 10.5% until June 1, 2016.



Since the beginning of 2016, there has been increasing political pressure to provide the so needed income tax relief to businesses as well as to individuals. Being 2016 year of general elections, these become critical for many governmental candidates. Many government officials have expressed their opposition to the implementation of the VAT and have proposed several Bills that promise to address the issues but that do not necessarily address the fiscal problem or the funding of such promised reliefs.

For example, House of Representatives Bills 2783 and 2784 filed on January 26 and January 27. The goal of Bill 2783 was to stop the VAT implementation and to eliminate the business to business Special SUT of 4%. On the other hand, Bill 2784's purpose was to postpone the VAT implementation until April 2017. Both of these projects were given a negative report by the Treasury and Budget Commission.

These Bills brought with them the possibility of a deferment of the effectiveness of the VAT implementation, a move that a great majority of businesses in Puerto Rico are

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betting on and are not taking necessary steps to be ready. This situation increased the uncertainty over the future of the Puerto Rico tax system. Nonetheless, the Secretary of Treasury has stated that the VAT will be implemented and that it is the only viable option to meet the Government's budget estimate.

Notwithstanding the fate of Bills 2783 and 2784, on March 11, 2016, the President of the House of Representatives filed House of Representatives Bills 2838, 2839 and 2840. All three are aimed to eliminate the VAT and replace it with additional excise taxes, increase the SUT rate, increase the municipal SUT, increase the foreign companies' tax, among other "solutions".

At present, Public Hearings are being held on all the Bills. The Secretary of the Treasury has expressed his opposition to all three, especially since they do not include funding provisions for the promised reliefs. The complexity of these proposed Bills have contributed to the confusion of businesses and taxpayers on this matter.

Even with the high levels of uncertainty, a percentage of businesses has incurred in costs for getting ready for a VAT implementation in order to be in compliance when the tax becomes finally effective. These costs include: upgrading their IT systems and engaging in tax consulting services for their business operations.

The VAT journey has been rough and with great opposition. But it is still seen as one viable solution to part of the fiscal problem; increase the collection of revenues. As of today, the VAT will be in effect on June 1, 2016, and just like Alan A. Tait describes it in his book, "Value Added Tax – International Practice and Problems"³:

"VAT may be thought of as the Mata Hari of the tax world – many are tempted, many succumb, some tremble on the brink, while others leave only to return, eventually the attraction appears irresistible"

In simple words: once a government starts considering the introduction of the VAT into an economy, the VAT, sooner or later, will be adopted.

Will you be ready by June 1, 2016?

Contact our Tax Department should you require additional information regarding this or any other tax issue. We will be glad to assist you.

³ Tait, Alan A. (1988) *Value Added Tax - International Practice and Problems*. Washington, DC: International Money Fund

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