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Kevane mailbag

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The Kevane mailbag is your link to our communications related to the operations of businesses in Puerto Rico. Our purpose is to offer you up-to-date information concerning tax, accounting and any other matters that might have an impact on the way you conduct business in Puerto Rico.

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Icon	Content
Audit	In this issue we will view the FASB discussion in the new ASU issued to simplify the subsequent measurement of inventory. Read related information on page 2.
Tax	The Commission for Alternatives to Transform the Consumption Tax (CATIC by its Spanish acronym) has issued its recommendations and report. Read more on page 3.
Advisory	Only about 50% of mergers or acquisitions will succeed — no matter how attractive the deal looks initially. Leveraging previous experience and using an integrated approach during M&A will lead to a sustainable and seamless integration process. Access the article on page 5.
Outsourcing	The Puerto Rico Department of Treasury has a virtual portal – "Colecturía Virtual" in which taxpayers can perform certain online transactions. Read more on page 10.
General Information	**September 2 -** Implementation process Join us in a series of four webcasts on **Value Added Tax** basics and their impact on your business operations. Click here for more details. **Save the Date! September 23 –** **Conferencia Implementación del IVA en Puerto Rico**. Conference will be conducted in Spanish. More: http://bit.ly/1I82Yom

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Audit Alert: New ASU – simplifying the measurement of inventory

FASB

All decisions reached at Board meetings are tentative and may be changed at future meetings. Decisions are included in an Exposure Draft only after a formal written ballot. Decisions reflected in Exposure Drafts are often changed in redeliberations by the Board based on information received in comment letters, at public roundtable discussions, and from other sources. Board decisions become final after a formal written ballot to issue a final Accounting Standards Update.

On July 22, the FASB issued ASU 2015-11, ***Simplifying the Measurement of Inventory***, which requires entities to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation.

The ASU will simplify the subsequent measurement of inventory, as current guidance requires an entity to measure inventory at the lower of cost or market. Under current guidance, market could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. In addition, the updates to inventory measurement in this ASU more closely align U.S. GAAP with IFRS.

The new guidance does not apply to inventory measured using last-in, first-out (LIFO) or the retail inventory method; therefore, subsequent measurement is unchanged for inventory measured using either of these two methods. The guidance is effective for public entities in fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. All other entities must apply the amendments in fiscal years beginning after December 15, 2016 and in interim periods within fiscal years beginning after December 15, 2017.

Entities should apply the amendments prospectively. Early adoption is permitted as of the beginning of an interim or annual reporting period.

Source: Grant Thornton, *On The Horizon*, July 30, 2015

We are committed to keep you updated of all developments that may affect the way you do business in Puerto Rico. Please contact us should further assistance is required in relation to this or any other matter.

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August 18, 2015

Tax Alert: The CATIC has issued its report. The verdict is…

As we all know, on May 29, 2015, Act 72 approved an increase to the current Sales and Use Tax to 11.5%, and eliminated the "business to business exemption" with the introduction of a 4% tax on services rendered to other merchants including "designated services". It also added Subtitle DD to the Puerto Rico Internal Revenue Code to introduce a new Value Added Tax system effective on April 1, 2016. Notwithstanding, Act 72 also created the **Commission for Alternatives to Transform the Consumption Tax (Comisión de Alternativas para Transformar el Impuesto al Consumo "CATIC").**

The main purpose of the CATIC was to evaluate the various available consumption tax systems, including the former Excise Tax system, and issue a report no later than sixty (60) days after the approval of Act 72-2015, recommending whether or not Puerto Rico should definitively migrate from the Sales and Use Tax system to a Value Added Tax system or any other consumption tax system that would prove to be more efficient. Act 72-2015 mandated that the CATIC should employ the University of Puerto Rico as its main advisor in this evaluation.

The CATIC's composition was also stated by Act 72-2015:

- The Secretary of Treasury (president of the CATIC);
- The Secretary of Justice;
- The Director of the Office of Management and Budget;
- The Executive Director of the Ports Authority;
- Two (2) member from the House of Representatives and two (2) from the Senate;
- Two (2) representatives from the private sector; and
- One (1) representative from the union sector to be appointed under mutual agreement by the President of the House of Representatives and the President of the Senate.

Before discussing the report issued by the CATIC, let's review the tax reform and political background that have served as prelude.

Act 72-2015 was the result of an intense political debate in Puerto Rico that commenced late in January 2015 when the Secretary of Treasury was obliged to make public the results of a study prepared by KPMG. Prior to that, specifically on August 17, 2013, the Governor of the Commonwealth of Puerto Rico issued an Executive Order creating the Tax Reform Advisory Group to analyze the current tax system, its rules and administration and report its conclusions and recommendations to build an effective and fair tax system. Interestingly enough the members of this Tax Reform Advisory Group were very similar to those of the CATIC:

- The Secretary of Treasury (president of the group);
- The Director of the Office of Management and Budget;

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August 25, 2015

- The President of the Government Development Bank for Puerto Rico ;
- The Secretary of Economic Development and Commerce;
- an economist;
- a CPA (the one appointed was Juan Zaragoza, the current Secretary of Treasury);
- an attorney;
- The President of the PR Chamber of Commerce;
- a labor union leader;
- The Executive Director of the Treasury Commission of the Senate; and
- The Executive Director of the Treasury Commission of the House of Representatives.

On March 18, 2014, the Department of Treasury (Treasury) hired KPMG to make a full assessment of the Puerto Rico tax structure and to develop a full report and set of alternative scenarios for the Treasury to evaluate. The goal: a simplified tax system that will provide the desired revenues through a more streamlined and effective system that should also result in more effective oversight.

KPMG's report made public by the Secretary of Treasury on January 2015, but dated October 31, 2014, recommended to replace the current tax structure with a broad-based single rate Goods and Services Tax (GST) with regressivity relief accomplished through direct transfer payments. This recommendation was provided after studying the four basic options for consumption taxation: the current system, a pure conversion to a sales and use tax, the return to the general excise tax and the one recommended the adoption of a broad-based GST. Both, the VAT and the GST are the same, it depends on the buyers or the sellers perspective. For the buyer, the GST is a tax on the purchase price. For the seller, the VAT is a tax on the value added to the product, material or service.

The KPMG study represented the cornerstone for the Tax Reform Bill filed by the Governor on February 11, 2015 which was defeated on April 30, 2015, a day later after a substitutive bill was filed.

The recommendations issued by the CATIC come with no surprises. On August 12, 2015, seventy four (74) days after the approval of Act 72-2015, 14 days after the prescribed sixty (60) days, the CATIC issued its report. If the result of that report would have been a recommendation to return to the Excise Tax System, the CATIC would have had a ten (10) days period to file legislation on that regard. Notwithstanding, as anticipated, the CATIC discarded the alternative of returning to the Excise Tax, pointing out among others, that the tax rate to obtain the same projected revenues as under current legislation, would need to be between 19% to 38% (instead of the 11.5% of the VAT).

Unfortunately, the political debate that has accompanied the enactment of this new tax system in Puerto Rico has played a defiant role for the private sector to adequately prepare for this major tax transformation that will directly affect every aspect of how we do business in Puerto Rico.

Based on the above, as of today, Puerto Rico will face a new VAT system, effective April 1, 2015. Businesses need to take all necessary steps to be ready and compliant by the effective date. You must act now, since an average VAT implementation process may take from three to four months.

On this regard, we want to invite you to participate of the Tax Conference we will host on September 23, 2015, addressing the new VAT system and its related implementation issues. For more information http://bit.ly/1I82Yom

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Advisory Alert: Integration playbooks drive long-term M&A success

Introduction

Only about 50% of mergers or acquisitions will succeed — no matter how attractive the deal looks initially. And often the newly created company will not deliver the hoped-for financial results.

With more and more companies growing through acquisition, acquirers need a better way to make deals work long term. The answer lies in improving the integration process — merged organizations must develop and follow through on a fundamental, sustainable integration plan.

Why integration doesn't work

When it comes to integration, even companies who do acquisitions on a regular basis seem to go through the process as if it were their first time. These companies designate a new integration manager for each acquisition, with good intentions — this is a major job and the right person may be the one with specific experience. But inventing a new integration wheel for each acquisition fails to leverage the experience of those who have gone before. Institutionalizing this knowledge into a sustainable, repeatable process is critical for future success.

Too much planning and institutionalization can also stifle creativity and adaptability. In these cases, the integration process becomes so structured and rigid that it loses its agility. An effective integration playbook provides the structure for both pieces of the puzzle.

A case study in overplanning

When a Fortune 500 technology company acquired a Boston-based supplier, members of the acquisition team went through a robust due diligence process that included an integration checklist with several thousand line items. All the boxes got checked, but integrating the acquired company's health plan turned into a major mistake when it became apparent that the new plan had no providers in the Boston area. Despite the attention given to the integration process, the acquirer just couldn't see the forest for the trees.

Finding a balance

Seventy-five to 80% of integration tasks are repeatable, which is why it seems that having a good integration process and checklist is the right solution. The problem with the checklist approach is twofold. First, as illustrated by the Fortune 500 acquirer discussed in the case study, human thought and common sense are integral to the process. Second, when staring at a massive checklist, the first reaction can be to simply start checking off tasks. Yet, not all tasks carry the same level of importance.

As an example, putting people on the acquirer's payroll and taking steps to retain key employees are both part of a typical checklist. Yet one is much more important than the other. Finally, people would rather get back to their day jobs rather than labor through busywork, so often they are more focused on simply getting through the checklist rather than prioritizing the tasks within it.

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August 10, 2015

The bottom line is that no integration plan can consist solely of checklists. There must be some stage in the process in which standard activities are tweaked and additional tasks are added in order to address the unique attributes of each transaction. This, in turn, can lead to a sustainable, repeatable process for M&A.

Getting integration right

There are two areas — aligning the vision and assessing the risk — that are often missing from many checklists. These require significant thought in order to lay the foundation for a successful integration effort.

Align the vision

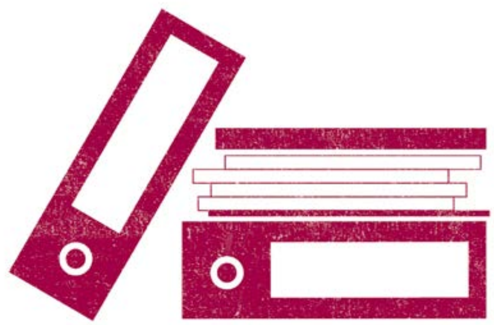
Probably the single greatest reason that acquisitions do not achieve the anticipated returns is because the vision is not clearly aligned with the integration plan. The vision is the investment thesis — or the why — of the proposed transaction. For example, if part of the value proposition of the transaction is attaining certain synergies, the integration plan should prioritize specific tasks to capture them.

Another critical part of aligning the vision to capture value lies in effectively engaging people when taking control of the acquired business. Without clearly understanding what each employee does and how their job outputs are supporting the investment thesis, the acquirer's chances of success diminish.

Assess the risk

Performing a comprehensive risk assessment must be an integral part of the integration plan. Risks can come from a variety of sources, from competitors to key employee retention to meshing the cultures and so on. Only when the company properly identifies the risks can it develop mitigation strategies as part of the integration planning process.

The following is a framework for assessing the most important transaction-related risks. Risk assessment is vital to identify potential areas of concern so that mitigation plans can be developed. These mitigation plans should then be translated into a series of tasks that would be addressed by the appropriate integration teams.



Aligning the vision to capture value

Infrastructure

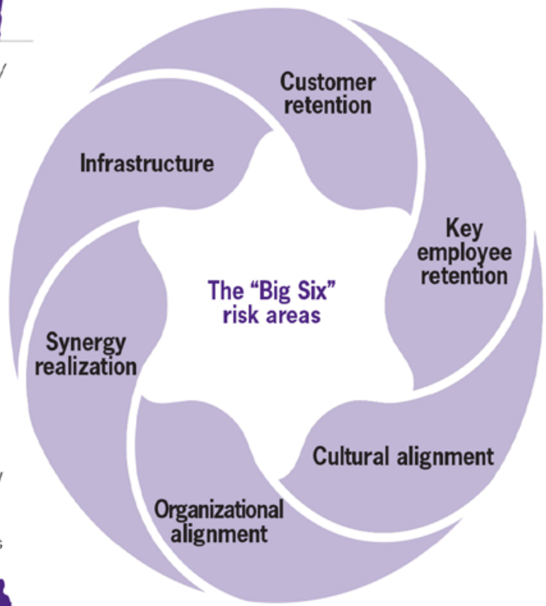
- Supporting continuous financial/ operations tracking while evaluating, designing, implementing and migrating to a long-term recommendation
  - IT systems
  - Accounting processes
  - Internal controls

Synergy realization

- Developing capture plans for identified sources of value (targeted cost reductions, process improvements, changes)
- Improving operating margins by rationalizing core and noncore functions and businesses
- Rationalizing noncore operations

Organizational alignment/ operating policies

- Designing an organizational structure:
  - Enhance the value of the combined organization
  - Focus on revenue enhancement, cost reduction and cost avoidance
- Identifying critical Day One operating policies



Customer retention/ strategic relationships

- Identifying key customer, prospect and strategic relationships
- Identifying key opportunities for revenue growth
- Stabilizing operations

Key employee retention

- Identifying and retaining employees key to commercial relationships and business continuity
- Reducing productivity decline
- Addressing potential lapses in safety during transition

Cultural alignment

- Aligning behaviors to achieve the desired strategic objective
- Leveraging commonality, addressing the differences
- Recommending an end-to-end solution to reduce productivity decline

Developing the integration playbook

An integration playbook codifies previous experiences and helpful tools, and contributes to the M&A intellectual capital of an organization. This can be extremely valuable for future transactions, because it capitalizes on past lessons learned. Furthermore, integrating a methodology within the playbook that provides for establishing a basis for emphasis areas and efforts (i.e. Critical, Significant and Other areas) provides for enhanced agility and flexibility in the process of applying prior experiences to new transactions.

Start by developing an integration framework — which functions or areas will be integrated and which will the newly acquired company have some ongoing latitude to keep as is? It is interesting to note that when we begin this analysis process, most clients initially think that 25–50% of the business processes will be integrated. However, after we complete the assessment, they often discover that 75% or more both can and should be integrated.

As an example, most accounting, financial reporting, tax and treasury processes are generally integrated as soon as possible. This is particularly true with public entities, because it is important to move quickly toward a common control environment. Closely related to this is the enterprise resource planning platform, which is also generally aligned. HR, employee benefits and insurance programs are also prime candidates, as are safety policies, since there is risk when a company has varying standards for safety and health.

Often, both sides want the sales organization to remain independent. But even if they remain independent, it is still important to align sales management processes, forecasting, legal review of contracts and other related processes.

Common sense trumps a checklist every time.

This ultimately leaves functions like operations and R&D, where there may be some latitude for independence. Thus, as part of the assessment process, a company can decide which parts of the business will be integrated and which will remain autonomous.

All this creates an integration framework tailored to the acquirer's specific needs for each future acquisition. It also provides a control — there has to be a valid business reason to deviate from the defined framework. Finally, it often creates goodwill during the negotiations and transition when an acquirer can be transparent with the target regarding its integration framework.

One size may not fit all

A highly acquisitive company may have more than one integration playbook. For example, one might be established for homogenous, tuck-in type transactions. Another might exist for a transformational deal, such as creating a new growth platform where there will be relatively greater autonomy than a tuck-in deal.

Humans are required

People with actual integration experience are still required to execute the playbook. It takes experienced insights to make the decisions that are necessary to align the vision of the transaction with the integration process. It also takes experience to accurately perform the risk assessment. The truth is that common sense trumps a checklist every time.

Not everyone associated with an integration effort needs to have prior experience, which is why the process should be codified. While the playbook is a useful tool to provide guidance and structure, the integration leaders do need experience so that they can evaluate the nuances of a particular transaction and make the appropriate adjustments to maximize success. As we have said, while 75–80% of tasks are generally common across all integrations, there is still a portion that needs to be aligned to the specific circumstances. Generally, it is experience (either an internal resource or external adviser) that bridges this gap.

Choosing the right integration leader and capturing their learnings

For those organizations that want to create a sustainable, repeatable process, the No. 1 challenge to creating internal intellectual capital is the retention and availability of the knowledge gained through experience.

Creating the next generation of company leaders

On a typical integration effort, the integration leader will see every facet of the acquisition, creating invaluable insights for the COO or divisional leader of the acquiring organization. In fact, it is not uncommon for the integration leader to take on an elevated role or, in some cases, to end up running the acquired operation, because of the knowledge gained by going through the process.

The long-term solution comes when the acquiring organization maintains a process coach.

Conclusion

An integration playbook can be a powerful resource to create a sustainable, repeatable process within a highly acquisitive company. It provides the necessary intellectual capital and only improves with continued lessons learned. Such a playbook must be more than a series of checklists, however. It requires a well thought-out foundation, linking the value drivers and vision of the transaction to the overall integration process, and completing an adequate risk assessment, which requires significant experience. In addition to the integration playbook, actual experiential knowledge is also important, and the effort must be driven by a strong leader.

Bibliography

Galante, D., Kleinguetl, E., Hwang, E. (2015, June 12). *Integration playbooks drive long-term M&A success*. Retrieved from Grant Thornton LLP: http://www.grantthornton.com/issues/library/articles/financial-services/2015/AM/integration-playbook.aspx

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Outsourcing Alert: Online transactions - Puerto Rico Department of Treasury

As the Department of Treasury continues with its reorganization and the closing of tax collectors' offices, know that you can make tax payments and obtain debt and tax filing certifications from the Puerto Rico Department of Treasury from the comfort of your home.

The "Colecturía Virtual Portal" of the Puerto Rico Department of Treasury allows you to make serveral payment transactions through a secured website.

The following transactions are available through the portal:

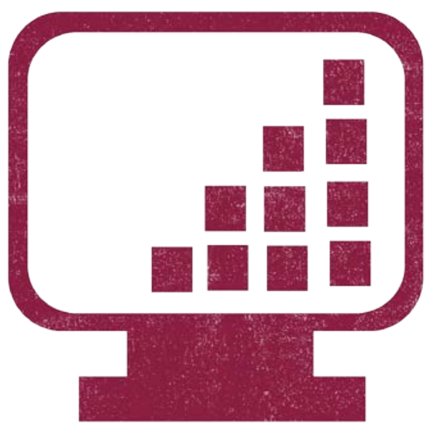
- Payment of the Second Installment – Individual Income Tax Return
- Payment of the Estimated Tax
- Payment of the Withholding of Tax at Source from Wages
- Estimated Tax Payment Section1123(f)
- Deposit Coupon of Tax Withheld at Source - Non-resident 480.31
- Deposit Coupon of Tax Withheld on Royalties 480.32
- Payment of the Withholding of Tax at Source from Services Rendered (7%)
- Automobile Importers Excise Tax Declarations
- Carriers and Custom Brokers Excise Tax Declaration
- Tax Alcoholic Beverage Declaration

Other services:

- DTOP – Payment of traffic violations
- Filing of Monthly Excise Taxes Return on Gasoline
- Request for Extension of Time for Income Tax Return
- Debt certifications to Individuals and Corporations
- Filing Certifications to Individuals and Corporations
- Verification of Tax Returns Status or Refunds
- Access Code and Control Numbers Notification search
- Validation and Transmission of Informative Files
- Validation and Transmission of W2 and W2c Files

Link – "Colecturía Virtual Portal"

https://colecturia.hacienda.gobierno.pr/portal/



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