Kevane mailbag

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Kevane Grant Thornton LLP
33 Calle Bolivia Ste 400
San Juan, Puerto Rico 00917-2013
T + 1 787 754 1915 F + 1 787 751 1284
www.kevane.com

Our Kevane mailbag is your link to all 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.

The Alerts contained in our mailbags can also be accessed through our website under the Publications tab\Professional Articles section or by downloading our business and tax application for mobile, tablets and iPad for free through the App Store and Google Play. We welcome your feedback at kgt@pr.gt.com

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Audit

The Securities and Exchange Commission has adopted the Final Rule for crowdfunding mandated by Title III of the JOBS Act. The Final Rule also limits investments made by individuals in crowdfunding offerings.

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Tax

The Municipality of San Juan has instituted a development and tax incentives program for the establishment of new businesses and the creation of new jobs. Existing businesses, under certain circumstances, can also benefit.

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Strategic risk, revenue growth risk and operational risk. Three types of banking regulations that keep regulators up at night.

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Outsourcing

A caregiver's leave has been approved in Puerto Rico for employer's covered under Act 80- the Minimum Wage, Vacation and Sick Leave Act. It is effective immediately after its approval.

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General Information

Follow our Facebook and LinkedIn series of VAT Industry Guides posts. The VAT tax system will replace the Sales and Use Tax not later than June 1, 2016.

Audit Alert: SEC adopts Regulation Crowdfunding

On October 30, the SEC adopted the Final Rule, *Crowdfunding*, mandated by Title III of the JOBS Act (Jumpstart our Business Startups Act), to allow smaller companies to raise a maximum of $1 million through crowdfunding offerings in a 12-month period and to exempt those companies from registration requirements under the Securities Act of 1933 and the Securities Exchange Act of 1934 (Exchange Act). The Final Rule also limits investments made by individuals in crowdfunding offerings.

Companies that conduct a crowdfunding offering are required to file and disclose certain information to the SEC and their regulated intermediary (either a broker-dealer or a funding portal). That information includes, among other things, financial statements either reviewed by an independent accountant or audited by an independent auditor, depending on the amount offered. Reviewed financial statements will be permitted for first-time filers under the Final Rule, unless audited financial statements are available.

The exemptions under the Final Rule are not available to certain companies, including non-U.S. companies, companies already subject to Exchange Act reporting, certain investment companies, companies that are considered disqualified under Regulation Crowdfunding or that have not complied with the annual reporting requirements during the most recent two years, or companies with no business plan or current operations.

The Final Rule will become effective 180 days after publication in the *Federal Register*.

With the adoption of this Final Rule, the Commission has completed all major rulemaking mandated by the JOBS Act.

Source: Grant Thornton, *On The Horizon*, November 5, 2015

We are committed to keep you updated of all developments that may affect the way you do business in Puerto Rico. Please contact if we can be of further assistance in relation to this or any other matter.

Contact us
For assistance in this matter, please contact us via luiscarlos.marcano@pr.gt.com

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An instinct for growth™

Tax Alert: New incentives by the Municipality of San Juan

In search of sustainable economic growth through the establishment of new business enterprises, thus spurring job creation and the rehabilitation of the city, the Municipality of San Juan ("MSJ") recently instituted a new development and tax incentives program under Chapter VI of the municipality's Economic Development Code (the "Program").

The Program is aimed at facilitating the establishing of new business throughout the following areas:

- the Santurce Urban Center;
- the Río Piedras Urban Center;
- the Condado area;
- the San Juan islet;
- designated zones within the MSJ's Territorial Plan, such as:
  - La Perla
  - El Gandul
  - Parada 27
  - Villa Clemente
  - Cantera
  - Quebrada Arenas
  - Puerta de Tierra
  - Trastalleres
  - Villa Palmeras
  - Barrio Obrero
  - Cupey Alto, among many others.

New businesses that decide to commence operations within the aforementioned areas will enjoy the following benefits under the Program:

- one hundred percent (100%) exemption from Municipal License Taxes for a period of five (5) years; and
- one hundred percent (100%) exemption from Personal and Real Property Taxes for a period of five (5) and ten (10) years, respectively.

Existing businesses may also request tax incentives under the Program, as long as (i) capital investments in excess of $75,000 are made, and (ii) either five (5) or more full-time jobs are created and maintained, or ten (10) part-time jobs with a requirement of no less than 900 hours per part-time employee. The benefits for existing businesses are the following:

- exemption from Municipal License Taxes for a period of five (5) years – the exemption percentage will be determined by the MSJ on a case-by-case basis; and
- one hundred percent (100%) exemption from Personal and Real Property Taxes for a period of five (5) years.

Moreover, new or existing business enterprises whose operations are outside of the Program's development areas may file a petition for incentives. The economic benefit to the community, such as the creation of 75 new jobs, the construction or rehabilitation of commercial buildings, the construction of parking space and the capacity for attracting visitors, will be evaluated in each case to determine the kind of benefits to be bestowed on the petitioner.

Contact us
For assistance in this matter, please contact us via
maria.rivera@pr.gt.com
francisco.luis@pr.gt.com
lina.morales@pr.gt.com
isabel.herandez@pr.gt.com

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Advisory Alert: Three types of banking regulations that keep regulators up at night

Recent foreseeable events in the Puerto Rican economy, such as the increasingly likely default on its $72 billion public debt, have raised concerns among lenders and credit facilities, especially in the banking industry. Last September, the Commonwealth released a five-year recovery plan that said even significant spending cuts would leave the island billions of dollars short of the amount needed to pay bondholders in the next five years. On January 1st, the Commonwealth missed about $37 million in payments which attracted the attention of several bond insurers.

As the island's economy continues to struggle with high unemployment rates and declining population, local banking and credit industry regulators, such as the Office of the Commissioner of Financial Institutions (OCFI) and the Puerto Rico Credit Unions Supervision and Insurance Corporation (PRCUSIC), recognize the public's concern and are on the lookout for inherent risks to the sector.

The vigorous regulatory response to the financial crisis, coupled with innovation in IT, has placed risk management at the forefront of bankers' concerns. As institutions strive to strengthen their risk cultures, regulators work to limit exposures that threaten the financial system. Three major risk themes — strategic, revenue growth and operational — have emerged as the focus of regulatory scrutiny.

Strategic risk

Gone are the days when banks could sketch out a strategic plan once a year, put it on a shelf, and feel confident they had fulfilled regulators' expectations. Regulatory agencies now demand robust strategic plans and call on boards of directors and management to follow them.

The financial crisis and its aftermath have brought many new challenges for banks. Regulators must ensure that bankers are prepared for the risks associated with them. For example, slow economic growth and continued low interest rates have led to diminishing margins and reduced profitability. Banks can be trapped into locking in longer loan terms and taking on higher levels of risk while they search for higher yields. Also, as

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For assistance in this matter, please contact us via ojel.rodriguez@pr.gt.com

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they compete with other banks and lenders for higher-yielding assets, there can be pressure to reduce interest rates to stay competitive. Often the risk pricing on new loans disappears.

Contending with tightening margins, managers and directors frequently turn to new, expanded or modified product offerings and service lines to improve performance. The regulators' concern is that many banks — particularly smaller community banks — have not performed the upfront risk analysis required for such a strategy. These banks may lack the necessary controls, the required expertise and, the appropriate information systems and risk management processes to effectively monitor and develop these new products and services. Instead of posting higher profits, banks can suffer credit losses, compliance issues and damaged reputations.

Faced with depressed earnings and capital challenges, some banks are shifting their focus to reducing noninterest expenses. While many institutions have successfully slashed operating expenses, the savings from these reductions has, in many cases, been offset by continued loan resolution costs (such as continued losses related to foreclosed assets), as well as increased expenses for regulatory compliance. Regulators are also concerned that the emphasis on reducing noninterest expenses will contribute to risks — such as diminished internal controls and increased personnel turnover — that may not surface immediately but could have a significant impact over time.

Revenue growth risk

Although the recession supposedly ended in mid-2009, slow growth in the economy continues to put great pressure on bank profitability. Banks are reporting some slow-paced loan expansion, but most observers believe significant revenue growth requires stronger Gross Domestic Product (GDP). At the same time, heightened competition for "bread and butter" loans in the commercial and industrial sectors (where the bulk of the banks' business loans typically reside) has also affected earnings.

With banks competing intensely on rates, regulators are increasingly concerned that risk pricing of loans has evaporated. They fear future loan losses will surface, and banks will not have been compensated for the risk they have assumed.

A large portion of the earnings across the banking industry in 2010 and 2011 resulted from reductions in provisions for loan losses in the face of an improving economy. But the current regulatory concern is that those provisions have stabilized, and continued reliance on reduced provisions will cause banks to fall short of their profit goals — once again pressuring institutions to seek revenues and earnings elsewhere.

Operational risk

Banks have increasingly turned to outsourcing, process re-engineering and investments in technology, such as applications for mobile banking, in search for opportunities to reduce operating costs. But in the eyes of regulators, these improvements are often accompanied by increased risk stemming from reductions in internal audit activity and weaker internal controls.

For regulators, outsourcing increases the risk of excessive reliance on third-party vendors. Banks must therefore be diligent in negotiating and monitoring contract terms and other vendor management issues. At the same time, as more banks roll out mobile capabilities, they also must contend with vastly greater cybersecurity risks, which in turn require even more investment of capital. Banks will have to shore up their firewalls against identity theft, fraud and theft of their proprietary information to protect their customers, their reputation, and their capital.

Regulatory compliance, particularly the myriad consumer compliance requirements, has been an increasing exposure for banks in the last three years since the approval and implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. In some cases, banks were so focused on managing credit risk during the crisis that insufficient attention was paid to training, auditing and processes surrounding compliance. Efforts to reduce costs, heightened turnover and reductions in personnel compounded the problem, leading regulators to conclude that risk was expanding in the compliance area. The increasing sophistication of money launderers and other criminal participants only added to this view.

The result has been greater regulatory scrutiny and mandatory compliance examinations for nearly all banks as part of safety and soundness. It is not unusual for noncompliant banks to be subject to severe penalties, including fines, regulatory orders/agreements, and requirements for additional training, auditing and reporting.

Bibliography

Katz, J., Jordan, N. (2013). 3 types of banking risks that keep regulators up at night. Retrieved January 15, 2016, from: http://www.grantthornton.com/~/media/content-page-files/financial-services/pdfs/2013/BIS/130925-FIS-Top-three-bank-risks-white-paper-131003.ashx

Call us to make an appointment with one of our experienced advisors. We will be glad to assist you.

Outsourcing Alert: Employees can use accrued sick leave to care for "qualified family member"

On December 31, 2015, the Governor of Puerto Rico signed Law No. 251 to amend the Law No. 180 of July 27, 1998, known as Puerto Rico's Minimum Wage, Vacation and Sick Leave Act.

Law No. 251 allows employees who work under Act 180 to use up to five days of accrued sick leave per year to care for a sick "qualified family member".

Qualified family members

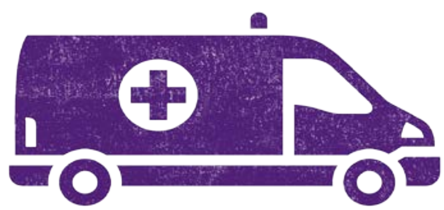
Qualified family members are:

- sick children
- spouse
- parents
- sick minors, persons of advanced age (60 years of age or older), or disabled persons under the employee's legal custody or guardianship.

To be eligible to take caregiver's leave, employees must have more than five accrued paid sick days and be able to maintain an accrued minimum sick balance of five days. If an employee does not have more than five accrued sick days, the employee is not eligible to take caregiver's leave.

This law applies to businesses with more than 15 employees and it is effective immediately after its approval.

Links:
http://www.lexjuris.com/lexlex/Leyes2015/lexl2015251.htm



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For assistance in this matter, please contact us via
julio.villegas@pr.gt.com
or
carmen.rojas@pr.gt.com

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