CARIBBEAN BUSINESS

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Private sector:

Here's your new law

Exclusive preview of the 2008 Puerto Rico Socioeconomic Development Incentives Act; multi sector committee to present proposal next week

By Frances Ryan & Carlos Márquez

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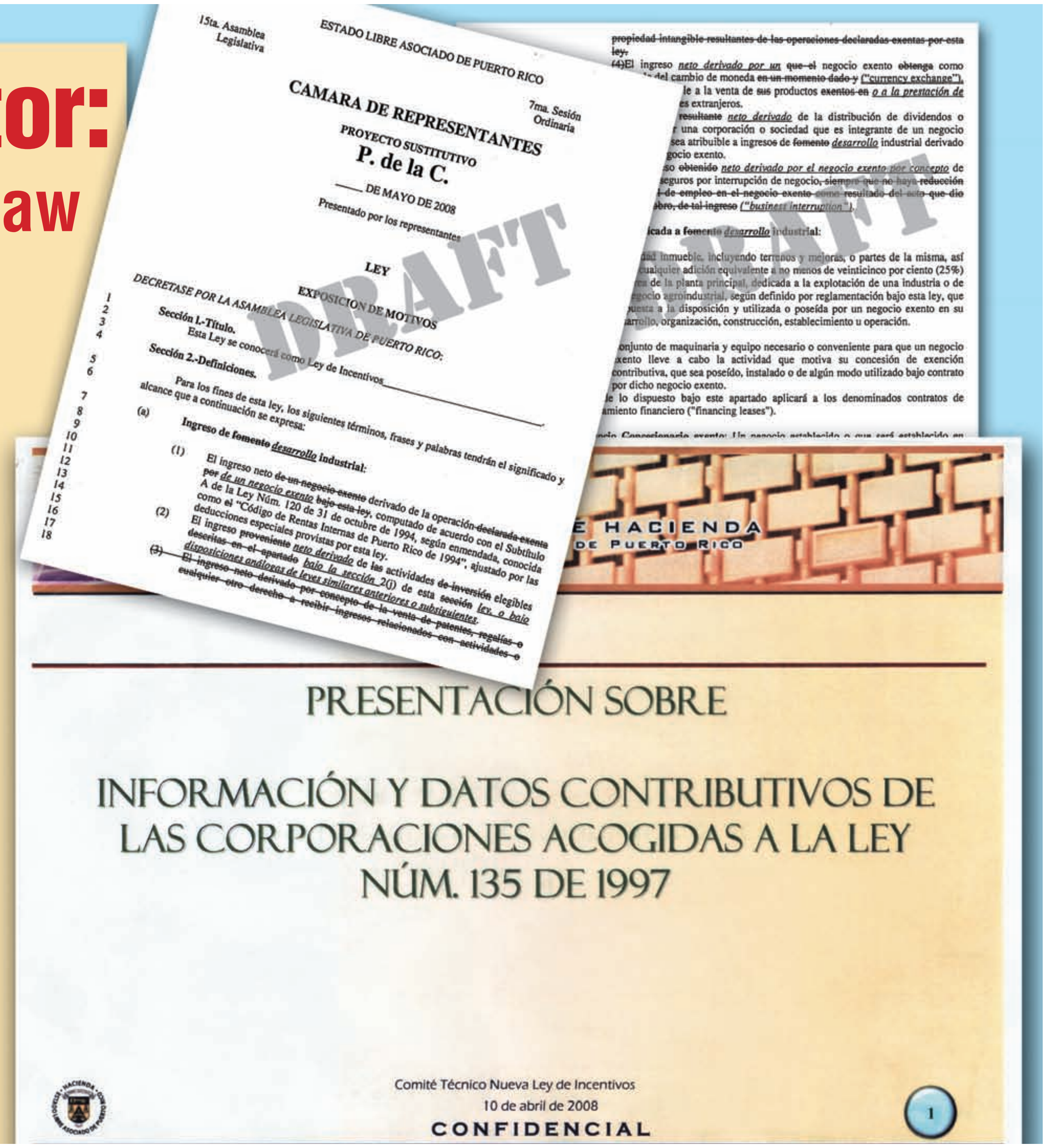

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Local government mulls acquisition of 2,000 acres at Roosey Roads if land not sold to private buyer

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Time is up

Legislature's and Governor's approval required before June 30, but it isn't over until it's over

Since a six-month extension of the Puerto Rico Tax Incentives Law of 1998 was approved by the Legislature, a multisector steering committee and a technical committee have been revising—and rewriting—House Bill 3798 and Law 135 of 1997, aiming to establish the new 2008 Puerto Rico Socioeconomic Development Incentives Act. The proposal will introduce economic development recommendations ranging from incentives for small and midsize businesses and a broader definition of the manufacturing sector to intellectual property and new tax incentives.

BY FRANCES RYAN & CARLOS MÁRQUEZ
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A much-awaited legislative proposal that is expected to return economic growth and development to the island will finally be filed in the Legislature next week.

Less than a week before the proposed bill to create the 2008 Puerto Rico Socioeconomic Development Incentives Act is filed, CARIBBEAN BUSINESS gained unprecedented access to the ongoing work of this top-secret legislative initiative.

At press time Monday, a number of crucial issues were still being discussed and were yet to be decided. Most importantly, the actual tax rate for eligible companies covered by the law is yet to be decided. But what follows is a pretty accurate description of the major provisions that have already been decided upon, as well as a good approximation in the case of the key issues still to be resolved such as the effective tax rate.

The first stage of the saga involving the Puerto Rico Tax Incentives Law of 1998 (Law 135 of 1997, or TIL) was over late last year when the private sector changed directions and agreed with House Speaker José Aponte to work together on a new incentives law in exchange for a six-month extension of the law—which was due to expire Dec. 31, 2007—until June 30, 2008. But now time is running out, and existing hurdles must be resolved within the existing timeframe.

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Since October, when the Legislature approved the six-month extension of the TIL, a multisector steering committee and a technical committee have been revising—and rewriting—House Bill 3798 and Law 135, aiming to establish the new 2008 Puerto Rico Socioeconomic Development Incentives Act.

Members of both committees have agreed to keep a tight lid on the proceedings until April 28, when details of the proposal will be shared with key legislators and island mayors followed by a presentation to a wider group of legislators and mayors April 29 and a public presentation April 30. As a result, sources quoted in this story—all members of either the steering committee or the technical committee—agreed to talk to CARIBBEAN BUSINESS on background.

A substitute bill to H.B. 3798 is expected to be filed on May 1.

Members from both major political parties, representatives from the private sector—small and large companies—and political leaders from the Legislature and Executive branch have devoted thousands of man hours to the thorough review of the law and the proposals that will make up the new legislation.

Amazingly, for months they have managed to stay above the political fray (for now) and leave out of the discussions the accustomed aggressive tone and good-for-nothing political rhetoric that has paralyzed the island's legislative and governmental efforts during the past years.

The proposal is expected to bring together aspects of the present TIL (Law 135) with House Bill 3798 and new proposals presented by a technical committee made up of approximately 20 representatives of the public and private sector.

These cover the following economic development areas: economic incentives for small and midsize businesses; a broader definition of the manufacturing sector; provisions to protect future intellectual property; service-related benefits, tax incentives and credits to attract, retain and train world-class scientists; and energy-efficiency and renewable energy initiatives and financing.

By all accounts there has been a very professional and intelligent yet intense debate on all key areas of the existing law, and heated discussions are expected to continue until the eleventh hour before reaching consensus on what core incentives the new law must provide.

House Speaker José Aponte

Senate President Kenneth McClintock

"The statesman-like tone of those working on this effort, an effort directed by House Speaker José Aponte, will definitely surprise many. Most importantly, it will provide Puerto Ricans with a glimmer of hope such that perhaps they can eventually regain trust in their leaders both from the private and public sector. In addition to meeting our commitment to craft a piece of legislation that will establish the basis for Puerto Rico to be competitive in today's global markets, the conduct of this group and the commitment to the process will be without a doubt one of the most important accomplishments of this effort," said a member of the steering committee.

"This is not to say we haven't had, and probably will continue to have, our passionate debates and share of disagreements. That's actually good and necessary in every democratic effort. But we all know the people of Puerto Rico are watching. And beyond the critical nature of this legislative initiative and the positive results that will be evident once the bill is filed, all eyes are on us. People are watching how we conduct ourselves; they expect us to come together, set an example and show that regardless of where we come from or what we believe in, we can still agree to disagree on matters that are important to us all. Most importantly, that at the end of the day we were able to put Puerto Rico's well-being above all," he added.

Members of the Steering Committee include House Speaker José Aponte; Senate President Kenneth McClintock; Chief of Staff Jorge Silva Puras; Economic Development Secretary Bartolomé Gamundi; José Julián Álvarez, president of the Puerto Rico Chamber of Commerce; Edgardo Fábregas, president of the Puerto Rico Manufacturer's Association; Manuel Figueroa, president of the Puerto Rico Products Association; and Francisco Rodríguez, president of the

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Puerto Rico Corporate Income Taxes ($ in 000's)

Year	Corporations / Total	Tax-Exempt	Non-Exempt
2003	$1,776,985	$880,000	$896,985
%		49.5%	50.5%
2004	1,831,027	924,000	907,027
%		50.5%	49.5%
2005	1,870,937	937,000	933,937
%		50.1%	49.9%
2006	1,872,458	1,306,000	566,458
%		69.7%	30.3%
2007	2,007,902	1,168,000	839,902
%		58.2%	41.8%
TOTAL	$9,359,309	$5,215,000	$4,144,309
%		55.7%	44.3%

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Puerto Rico Private-Sector Coalition. Another 21 members from various sectors are part of the technical committee.

Here is an exclusive CARIBBEAN BUSINESS preview of the proposal:

Overview

At a glance, the new legislation will indeed be more diverse and encompassing of other economic-related sectors that interact with the industrial sector than the existing TIL (Law 135). In that sense, the new legislation will benefit not only the manufacturing sector but other industries as well.

However, it does not pretend to be everything to everyone. Specifically, the new law will not amend the tax code across the board to provide for lower corporate tax rates to all businesses as is being called for by many business sectors on the island.

And in efforts to avoid duplication, the new law doesn't extend to some areas where other incentives laws already provide for economic development opportunities as is the case of tourism, housing and other social and economic sectors.

Instead, the new legislation will primarily address the changing nature and needs of Puerto Rico's industrial sector and its competitiveness.

First, it broadens the definition of eligible businesses and changes the definition of manufacturing to include processes that are an "essential part of the intellectual process." In that sense, the kinds of businesses that will be able to benefit from the incentives are broader than under the old law.

It also takes into account the often-forgotten local small- and midsize-business sectors which, in many instances, benefit from the primary activities of the industrial sector.

"The situation for the island's manufacturing sector has worsened as a consequence of skyrocketing utility costs, a slow and inefficient permit process, costly labor legislation that does not promote employment creation and overregulation which further deteriorates the island's overall competitiveness. The proposed legislation is expected to address some of these issues," said a source.

In a nutshell, discussions and negotiations during the final stretch will primarily focus on the following main areas: taxes, strategic projects, a development fund and its board of directors, energy credits, permits, the definition of research and development and "pioneer" industries.

Expanded definition of eligible activities

A fundamental area of the new law will be the expanded definition of eligible activities for tax incentives, making sure it reflects today's market reality. This could result in the substantial growth of companies—some already doing business on the island, others new—that would benefit under the law.

Multiple proposals on tax rates

Most of the critically undecided aspects of the bill as of press time Monday revolve around fundamental issues such as tax rates, whether they should be fixed or progressive, tax credits versus tax deductions and royalty payments.

Chief of Staff Jorge Silva Puras

Economic Development Secretary Bartolomé Gamundi

As expected, tax rates—including issues that go from how much the so-called tax-exempt companies should pay to lowering the tax burden on local small and midsize businesses—are still the subject of intense debate within the steering and technical committees, particularly in view of the ongoing federal Internal Revenue Service (IRS) tax audits of all Controlled Foreign Corporations (CFCs.) The IRS is auditing all U.S. corporations that had operating subsidiaries on the island under Section 936 of the U.S. Internal Revenue Code (IRC) and converted to CFCs. Tax liabilities for billions of dollars in their treatment and allocation of reported corporate income and profits are being challenged.

Options run the gamut from 0% income tax rate and letting the general fund pick up the tab by subsidizing this tax revenue shortfall to a higher 10% tax, to the increasingly popular recommendation of a 5% flat tax including royalty payments. By the time the bill is filed May 1, the final recommendation on taxes should be somewhere in the middle.

Tax-exempt companies under the old law reported sales of more than $50 billion, earnings of more than $35 billion and paid upwards of $540 million in taxes. According to the local Treasury Department's latest detailed reported figures to the technical committee, which date back to 2002, these companies are paying an average effective tax rate on net income of approximately 3%. Nevertheless, according to CARIBBEAN BUSINESS sources, in 2007 the real effective tax rate of these companies ranged between 1.5% and 2%.

'Pioneer' activities

The tax rate for "pioneer" activities could be less than 2% taking into consideration the economic impact the activity could have on the socioeconomic development of the island.

Royalty payments

There is also a withholding tax on nonresident companies of 10%, which provided $742 million in revenue to the general fund last year. Pharmaceutical companies paid $437 million, accounting for close to 60% of this tax. Nevertheless, this payment could be in jeopardy for future years due to the IRS' relentless and ongoing audits and potential federal policy changes regarding CFCs.

Although local-capital companies represent approximately 70% of all tax-exempt companies covered by the TIL (Law 135), 20 to 30 multinationals (most of them in the pharmaceutical sector) represent more than 80% of the reported sales, income and taxes paid. The pharmaceutical sector employs about 21,000 workers down from 35,000 in 2000.

Of all taxes paid by the entire corporate sector in Puerto Rico in 2007, more than 50% came from the so-called tax-exempt companies, i.e., companies covered by the old TIL (Law 135). (See chart).

On one side of the tax-rate argument, specifically those dealing with locally exempt companies, is the fear that if tax rates go up too much it will prompt many of them to pack up and leave Puerto Rico given the fact that right now their effective tax rate is estimated to be between 1.5% and 2% and, in any event, not more than 3%. Yet, to others, having a 0% tax rate subsidized by an already dried out, near-bankrupt general fund, sounds like a tough sell.

"Puerto Rico can't afford to have companies leave. Instead, we are working on a solution that allows us to protect what we have and create

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opportunities for new companies to come in as well as for local companies to effectively compete in global markets. That is possible, even if exempt companies have to pay higher taxes. How much higher, however, that is the question. How much is the incremental marginal tax rate that could be levied is the unresolved question," an industry source close to the process told CARIBBEAN BUSINESS.

On the other hand, a counter argument to the earlier position is: "We definitely have to protect what we have, but not at the expense of sacrificing everyone else or our prospects on emerging technologies."

"The transformation of the manufacturing industry worldwide, not just in Puerto Rico, continues to point us to new areas of opportunity within that sector. Most importantly, it is forcing us to accept the fact that, more and more, traditional manufacturing will continue to shrink. Intelligently, we can't continue to depend on that revenue base because, if we do, we run the risk of becoming extinct," said another source.

On the other hand, of all these large tax-exempt companies, just 20 to 25 of them carry the lion's share of paying taxes within the manufacturing sector indicating the industry's transformation points to the rapid shrinking of that tax-paying base.

This has left others more in favor of increasing the existing tax rate inclined to take a prospective look at what areas of the industry—including other sectors within the manufacturing value-added chain—as well as other economic sectors can be developed through tax credits and other tax incentives. Here's where the expanded definition of "eligible activities" under the law could open the door for Puerto Rico to insert itself in new biotech, high-tech and life-sciences opportunities by establishing an incentive structure that could help the local industry shift from traditional manufacturing activities to a cutting edge R&D and service-based economy, another source said.

It's not just taxes

Another major area of discussion—and consensus—has been bringing to the forefront of the discussions on economic development two major issues deemed the main culprits for strangling Puerto Rico's competitiveness: skyrocketing energy costs and the bureaucratic permit system.

From early on in this legislative effort, members of both the steering and technical committees unanimously agreed Puerto Rico's soaring electricity costs and bureaucratic permits system are two of the main culprits for asphyxiating the island's business community and keeping away prospects from investing locally.

"To the question of increasing taxes on these companies, many of the closings we have had (more than 750 in the last 10 years) respond in great part to a combination of factors, but almost none of them as a result of higher taxes," the source continued saying.

"Among those factors are skyrocketing costs of electricity and the completely denied access by the Puerto Rico Electric Power Authority (Prepa) to the private sector—even if the private sector wants to invest in alternatives—to work on joint solutions."

José Julián Álvarez, president of the Puerto Rico Chamber of Commerce

Edgardo Fábregas, president of the Puerto Rico Manufacturer's Association

Tax credit for job creation

The new law includes a $5,000 credit per job creation during the first year of operation or expansion. Since 1982, the Puerto Rico Industrial Development Co. (Pridco) has offered a $400 incentive per employee while in other jurisdictions this credit fluctuates between $3,000 and $5,000 per employee. The Treasury Department recommends the credit be limited and an annual ceiling implemented.

Dateline for permits

"On the permits side, we make the process to secure permits extremely complicated and long. By the time a company has a permit, it doesn't matter how many tax credits or incentives it receives from applicable tax-incentive grants. Their losses over time may not even make up for the incentives they receive. The foregone opportunity cost is much higher than the tax benefits received," said a source close to the process.

The proposal is expected to put the burden on the government allowing a period of 60 to 90 days for approval. If no action is taken by the corresponding government agency, the permit is deemed to be granted. Consensus on the permits approval period has yet to be reached.

Members of the steering committee met with the accountants and chief financial officers (CFOs) of some of the major tax-exempt companies with operations in Puerto Rico to gather their input for the process. "Interestingly, higher taxes or taxes in general, while one of the factors they will evaluate when determining new market allocations and expansions, is not the only criterion nor the one they're most concerned with when doing business in Puerto Rico," a member of the steering committee told CARIBBEAN BUSINESS.

"During the same meeting, several of the exempt companies said they wouldn't even mind paying higher taxes within a reasonable range if Puerto Rico can guarantee them the permits process can be substantially simplified and they can deal with one central authority instead of hundreds of agencies and municipal staff that don't communicate with one another, and that viable energy alternatives that enable them to control or reduce their energy costs are in place in the immediate future.

"For many of them, the time, money and human resources they waste in dealing with these issues sometimes weighs more on their corporate decisions than the potential of paying higher taxes," said the source, adding that despite the island's increasing cost of living, Puerto Rico still represents an attractive market for many of these companies and prospects, particularly nowadays when a weak dollar makes the Europe and Asia markets more expensive for companies.

When asked, accountants and CFOs of several of the exempt companies doing business in Puerto Rico specifically cited the extreme complexity of doing business on the island, from 78 municipalities with their individual idiosyncrasies, an unstable political environment, more than 30 intervening agencies in the permit process, an average of two to three years to secure construction and critical expansion permits, inconsistencies in public policies with permits granted later brought to question, and complicated local regulations on top of federal regulations and world-class certification processes. These are but a few of the things that turn many of these companies off when considering Puerto Rico as a potential market or future expansion.

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ROYALTY PAYMENTS

Although Puerto Rico law allows for 10% to 15% withholding tax on royalty payments to CFCs, the bottom line is that those that make more than 80% of tax-sheltered profits pay less than 2% effective tax rate and those that make less than 20% pay a higher rate. Therefore, some of the members of the technical committee are proposing a combined marginal tax rate of 5%.

SPECIAL FUND FOR ECONOMIC DEVELOPMENT

The proposal provides for the creation of the Special Fund for Economic Development, which will be funded by 5% of taxes paid under the new law.

ADDRESSING THE COST OF ENERGY

The proposal contemplates including certain energy-generating operations as businesses eligible to enjoy special tax benefits. Targeted credits are also being considered with that objective in mind.

Currently, the cost of the kilowatt per hour (KwH) from Prepa averages as much as 25 cents compared with eight to 10 cents in other jurisdictions.

Tax credits of up to 10% of the electricity bill paid by tax-exempt companies are being considered to be included in the new legislation. The cost will be initially paid by the general fund and then Prepa will start assuming part of the cost of the credits in annual percentage increments. The average tax credit for electric energy is estimated to be between 3% and 3.5%.

"The ridiculously high cost of energy and the backwards mentality of Prepa in dealing with the issue were atop the list of frustrating factors for those companies," said a CARIBBEAN BUSINESS source.

As part of the companies' input, the majority of them confirmed they have on several occasions offered Prepa multiple solutions to jointly address the energy situation to no avail. In fact, a couple of the companies interviewed said they would rather move their operations elsewhere than deal with the local power authority.

"Either we break the monopoly Prepa has, or the monopoly will break us," said a source.

"The problem of the high cost of electricity in Puerto Rico is so critical and Prepa's arrogant attitude so untenable and the union so callous that very soon it won't matter if we have the most generous economic incentives law in the world; Puerto Rico won't have a fighting chance of ever becoming the competitive and world-class economy it once was," said an inside source, capturing the overall sentiment of the talks about the energy situation on the island.

In an effort to counter the energy situation on the island, the new law will include attractive credits, incentives and deductions to promote the production of electricity with renewable energy sources such as wind, solar and others.

Manuel Figueroa, president of the Puerto Rico Products Association

Francisco Rodríguez, president of the Puerto Rico Private Sector Coalition

"Inevitably, as all the areas of competitiveness are addressed, Prepa will remain as the major stumbling block in the way of Puerto Rico's future economic development. And something will have to give," said a source close to the steering committee.

INCENTIVES FOR STRATEGIC PROJECTS

At editorial closing Monday, sources close to the legislative process confirmed the proposed bill is likely to include eight to 10 strategic initiatives of the 18 originally submitted in H.B. 3278. Companies involved in these strategic projects will be considered eligible to receive tax incentives under the new law.

Five of these strategic initiatives have already been approved by the steering committee and more are expected to be approved and written into the final text of the bill this week. Among these initiatives are the construction of dams, the clean up of waste disposal facilities and renewable electric energy generation.

INTELLECTUAL PROPERTY

"The area of intellectual property is one of the most exciting for Puerto Rico. If we make a real push to develop our scientific base and invest in developing and attracting world-class researchers, sound intellectual property incentives and validation processes will protect our investment in the long run. These intellectual rights will be our new currency in a diversified knowledge-based manufacturing economy," explained an industry source.

INCENTIVES FOR RESEARCH AND DEVELOPMENT

One of the benefits under consideration in this area is the credit for investment in research and development (R&D). Currently, Law 113 grants a deduction that is equal to the total cost of research and the investment in the development of new products or industrial processes. Total deductions under Law 113 are estimated at $3 million a year, according to Treasury Department statistics.

TAX BREAK FOR SCIENTISTS

Meanwhile, House Bill 4220, a separate legislative initiative co-authored by Antonio 'Toñito' Silva Delgado (NPP) and Hector Ferrer Ríos (PDP) and recently approved in the House of Representatives, aims at providing tax credits to facilitate the recruitment and retention of world-class scientists.

This proposal gained acceptance within the steering committee and, according to Treasury Department statistics, it is not anticipated to have a significant negative impact on the local tax revenue for the government. If an average of 50 scientists with an average $200,000 annual salary each are recruited on an annual basis, the economic impact of this proposal is only $300,000 a year.

TAX CREDITS FOR 'MADE IN PUERTO RICO' PURCHASES

The new bill offers big hope for small companies. A 10-point incentives platform should lighten the economic burden of many local small and midsize companies who pay an average 28% in annual corporate taxes, not to mention the towering cost of doing business on the island. Chief among those, the 200% increase in the monthly electric bill, another 100% in water utility bills, skyrocketing road tolls and food costs, have cost hundreds of local small and midsize companies to close up shop. In store for the small and midsize companies (Pymes, by their Spanish acronym), is the proposed credit for companies that purchase

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Growing frustration with Prepa's soaring electricity costs continue to dominate discussions as House of Representatives finalize proposal for 2008 Socioeconomic Incentives Act. "Either we break the monopoly Prepa has, or the monopoly will break us," a frustrated source –and member of the House steering committee--told CARIBBEAN BUSINESS. Cost of the kilowatt per hour (KwH) from Prepa averages as much as 25 cents compared with eight to 10 cents in other jurisdictions.

products made in Puerto Rico. The credit is expected to be equivalent to between 15% and 25% of the incremental purchase of these products using previous year averages.

Tax credits for buying locally manufactured products eliminates an existing base period and includes certain services. This credit amounted to $6.3 million in 2002, apparently the most recent numbers available at the Treasury Department. Only 27 tax filers used this credit.

Incentive for eligible investment activities

Income generated by certain eligible investment activities would be exempt from income, property and municipal taxes.

Conversion mechanism

No new applications for tax-exemption grants will be allowed under Law 135. Nevertheless, amendments to existing tax-exemption grants will be allowed.

To promote conversion to the new law, efforts are being made by House Speaker José Aponte to include Puerto Rico as a qualifying jurisdiction in a revenue procedure that is currently applicable to all U.S. state jurisdictions (IRC Section 243) which allows for all state jurisdictions to benefit from special dividend deductions to stockholders and parent corporations. A successful adoption of this revenue procedure to Puerto Rico will ensure a conversion mechanism to the new law to secure establishment of new R&D, biotech and distribution facilities (See sidebar). ■

Amendments to Section 243 of the Federal Internal Revenue Code proposed

BY CARLOS MÁRQUEZ & FRANCES RYAN
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CARIBBEAN BUSINESS learned the technical committee evaluating the proposal for the 2008 Puerto Rico Socioeconomic Development Incentives Act is considering proposing amendments to Section 243 of the Internal Revenue Code (IRC) of 1986.

Section 243 would be amended to treat qualifying U.S. possession corporations as domestic corporations for purposes of the dividend-received deduction only regardless of whether such corporations are subject to U.S. income taxes.

The proposed amendments to Section 243 are meant to treat certain corporations organized in U.S. possessions (including Puerto Rico) as domestic corporations only for purposes of allowing dividend-received deductions to their stateside corporate stockholders. To qualify, the U.S. possession corporations must derive at least 80% of their income from the active conduct of a trade or business within a U.S possession.

Under the IRC Section 243, a corporation is entitled to a special deduction of 70% of dividends received from a domestic corporation that is subject to income tax. If the stockholder owns 20% or more of the stock in the distributing corporation, then the deduction allowed is 80% of the dividend. The effect of this deduction is to reduce the effective rate on the dividend received to 10.5% or 7%, depending on whether the 70% or the 80% is allowed.

A 100% dividend-received deduction is allowed in connection with certain qualifying dividends. Qualifying dividends are those received by a corporation that is a member of the same affiliated group as the distributing entity. In this context, an affiliated group includes one or more chains of includable corporations connected through stock ownership with a common parent corporation which is also an includable corporation.

Ownership of at least 80% of the stock (by vote or value) is required. The term includable corporation under Section 1504(d) excludes foreign corporations.

Nevertheless, IRC Section 246 imposes certain limitations on the maximum amount of deduction that may be claimed. Such limitations would apply to the stateside stockholder of the U.S. possessions' distributing entity.

Section 1504(b) would also be amended to include U.S. possessions that comply with the 80% active business requirements as

> "This alternative should be neutral from a political standpoint. Different from prior proposals, it seeks to make available to U.S. possession corporations a deduction that is already available under the U.S. IRC, thus providing partial equality with corporations organized in the U.S."

"includable corporations" for purposes of the 100% dividend received deduction under IRC Section 243.

Stateside stockholders would pay federal income taxes on distributions received from the U.S. possession corporation with the benefit of the dividend-received deduction. No federal taxes would be paid if the stateside stockholder received a qualifying dividend and thus is allowed to claim the 100% dividend-received deductions.

This alternative would impact corporate stockholders that are subject to federal income tax and that directly own a U.S. possessions corporation. Entities with more complex corporate structures may not receive direct tax savings although other benefits are expected due to the potential increased availability of suppliers within the possession.

This alternative promotes the distribution of dividends into the U.S. and, at the same time, promotes the organization of Puerto Rico companies for operations on the island.

According to CARIBBEAN BUSINESS sources, "this alternative should be neutral from a political standpoint. Different from prior proposals, it seeks to make available to U.S. possession corporations a deduction that is already available under the U.S. IRC, thus providing partial equality with corporations organized in the U.S."

It also has an important precedent. Recently, Congress allowed capital gains tax rates to apply to certain dividends paid to individual U.S. shareholders by qualified foreign corporations including foreign corporations. ■

Bills to reduce income tax to small and midsize, non-tax-exempt corporations, individuals; United Retailers with major input

BY FRANCES RYAN & CARLOS MÁRQUEZ
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The technical committee evaluating the proposal for the 2008 Puerto Rico Socioeconomic Development Incentives Act is considering a list of recommendations from the United Retailers Association (CUD, by its Spanish acronym) to reduce income tax for small and midsize, non-tax-exempt corporations, CARIBBEAN BUSINESS has learned. In addition to the proposed corporate tax reductions for small businesses, additional forthcoming legislative proposals will recommend lowering personal income tax rates from the current maximum of 33% to 28%.

CUD, the largest trade organization of its kind with more than 12,000 active members, is proposing a series of tax incentives, credits and deductions that will level the tax field for the small corporations compared with the traditional benefits large tax-exempt companies have received under the Puerto Rico Tax Incentives Law of 1998 (Law 135 or TIL) which expired Dec. 31, 2007. Here is an exclusive CARIBBEAN BUSINESS preview of some of the incentives proposed to benefit small and midsize, non-tax-exempt corporations.

By definition, a small business will be considered one whose annual income doesn't exceed $5 million. Incentives will vary according to three net-income categories, $1 million, $3 million and $5 million.

PROPOSED INCENTIVES:

- A single tax of 20% for corporations whose net income doesn't exceed $5 million, a significant reduction compared with the existing 39%. And for those whose net income exceeds the $5-million, net-income threshold, the maximum tax would be 25%, still considerably lower than the existing rate.

New Socioeconomic Incentives bill offers big hope for small companies. A 10-point incentives platform should lighten the economic burden of many local small and midsize companies who pay an average 28% in annual corporate taxes. The United Retailers Association collaborated with the drafting of the economic incentives proposed for Puerto Rico's small business sector.

- Deductions during the fiscal year on computer equipment acquired by corporations with net income under $5 million, an important deduction compared with the existing three-year depreciation deduction requirement. Given technology's fast-changing pace, this would enable small businesses to invest in the latest equipment.

- Small business corporations will be able to deduct, within two years from purchase, the cost of equipment, transportation (not cars) and energy-efficient equipment used in the business. Currently, the depreciation threshold is five years. This proposal is in line with the Socioeconomic Incentives Act push for all Puerto Ricans and corporations to invest in energy-saving practices and equipment as a means of becoming more competitive.

- For businesses with net income under $1 million, the opportunity to get a deduction in their business income tax for the cost of individual health insurance and up to 50% in any federal income tax filing. Currently, there are no tax deductions on these business costs.

- A tax credit for qualified investors for any cash investment to acquire an existing business that is on the verge of closing operations. The proposed tax credit, currently not available, could help capitalize local small businesses.

- Recommendations also include eliminating the definition of personal property for businesses with net income of $5 million or less. This would eliminate the existing taxes small corporations pay on personal property, which includes inventory, office furnishings and equipment.

- Another proposal recommends doubling a business minimum sales threshold to be considered for tax exemption purposes from $150,000 to $300,000, and the tax-exempt amount, currently $50,000 to be raised to $100,000.

- Instead of paying 100% municipal taxes on businesses with net income of $1 million or less, the proposal suggests reducing municipal tax liability to 40% (or 60% exemption).

- Small businesses which currently do not enjoy the benefits of the State Insurance Fund would be allowed to participate under the new proposal. ■