Executive Summary

OCTOBER 2004

Fiscal Reform Law No. 288-04

FISCAL REFORM LAW NO. 288-04

Introduction

The present Executive Summary corresponds to Law No. 288-04 on Fiscal Reform (hereinafter called “the Reform”) which modifies the Tax Code, as well as other laws of a fiscal nature, which are stated below.

This summary is intended to become an information tool for the corporate community and the public in general, and as such, focuses on the most relevant aspects of said Reform. In addition, it is a new effort on the part of Pellerano & Herrera to keep its clients and others informed as to the most recent developments of national interest, as definitely is the Reform in question.

I. Background

In view of the difficulties experienced by fiscal authorities to achieve that a large segment of contributors fully comply with fiscal obligations set forth under the Tax Code (hereinafter called the Code) and other laws of a fiscal nature, during the month of December of 2000, through Law 147-00, a tax of 1.5% advance payment on gross income was created. Through the creation of this tax, which initially was called transitory, the tax authorities were trying to obtain a certain stability of collections.

In that respect, in January 2001 said tax was modified, through Law 12-01 which made it a mandatory minimum tax. That is, companies whose year income exceeded RD$6,000,000.00 were obliged to a minimum payment of 1.5% of gross income even in the case losses were declared.

This measure was accompanied by a tax evasion amnesty which was basically trying to help contributors have the opportunity to make transparent the totality of their equity. However, the effect of said Law was less favorable than anticipated by tax authorities because, for one reason or another, a significant segment of contributors did not take advantage of said Law.

The above shows that the efforts to increase collections were only partially successful. In view of the need of Tax Authorities to obtain more resources and in view of the

obstacles faced to obtain approval of a tax reform, the Government searched for ways to obtain additional income. From this need arose the promulgation of decrees 727-03 and 646-03, which imposed a 5% tax on exports and 2% on imports respectively, measures that were openly rejected by the sectors affected.

More recently, during 2004, the authorities decided to satisfy certain questionings made by the affected sectors giving the character of law to said decrees. To this end the taxes were introduced before the legislative chambers where they were approved and the Executive Power enacted them as laws 01-04 and 02-04.

Finally, in addition to the above are the Agreements with the World Trade Organization (WTO) and the potential Free Trade Agreement with the United States, which require the Dominican Government to generate significant income via the General Directorate of Internal Taxes (DGII), due to basically two reasons: the stripping of taxes represented by the Free Trade Agreement, which will drastically reduce collections obtained by the General Directorate of Customs and the imminent negotiation of an agreement with the International Monetary Fund.

II. Legal provisions which are abolished or modified by the Tax Reform Law

The Reform modifies the following laws:

a. Law No. 11-92 dated 16 May 1992, which established the Tax Code and its modifications;

b. Law No. 18-88 dated 5 February 1988, which established the Tax on Luxury Housing and Urban Non-constructed Lots and its modifications;

c. Law No. 2569 dated 4 December 1950 on Inheritance and Grant Taxes and its modifications;

d. Law No. 831 dated 5 March 1945 which subjects to a proportional tax the deeds intervened registrars of deeds;

e. Law No. 1041 dated 21 November 1935 which modified the Trade Code and provisions related to the formation of stock companies;

f. Law 147-00 dated 27 December 2000;

g. Law 12-01 dated 17 January 2001;

h. Law No. 831 dated 5 March 1945;

i. Law No. 6-04 dated 11 January 2004;

j. Law No. 3341 dated 14 July 1952;

k. Law No. 32 dated 14 October 1974;

l. Law No. 5113 dated 24 April 1959;

m. Law No. 3-04 dated 14 January 2004; and

n. Abolishes any other provision which is contrary to it.

III. Monetary penalties

In its *First Article*, the Reform adds to Paragraph of Article 248 of the Code – which relates to tax evasion– that the difference of taxes determined as a consequence of audits performed by the Tax Administration will be subject to surcharges established under Article 252 of the Code, which sets forth that arrears on surcharges will be 10% the first month or fraction of a month and an additional 4% for each subsequent month or fraction of a month.

Another monetary penalty imposed by the Reform is stated in its Fifth Article, where it provides that a paragraph be added to Article 288 as follows: “When a contributor files his sworn statement and in the inspection process objections are made related to literals a, b, and e of said Article, a monetary penalty will be imposed to the contributor equivalent to 25% of each expense objected, without detriment to the indemnity surcharges and interests that may be applicable”.

This new provision will significantly affect contributors since, in addition to indemnity surcharges and interests already existing, adds a new surcharge of 25%.

IV. Income Tax

The Second Article of the Reform expands provisions under Article 287 of the Code on Tax Allowances, specifically literal k, proposing that losses suffered by companies in their fiscal years and which are deductible from income obtained in the immediately subsequent fiscal years (not exceeding three fiscal years), under no circumstances, will be compensated during the present or future periods when said losses arise from other institutions with which the contributor has performed any type of reorganization process (after publication of the Reform).

This new provision will have a major impact on mergers and reorganizations which were in process.

Regarding the prerogative of deducting from gross income expenditures approved necessary to acquire, maintain and keep taxable income, granted under literal m of Article 287, the Third Article of the Reform adds a Paragraph to said literal, by which use of the prerogative becomes mutually exclusive from the use of the tax exemption provided for under Article 296 of the Code.

Although the reasoning supporting the measure is understandable, this provision is detrimental to individuals who fall under this provision.

Article Four adds a paragraph to literal d) of Article 288 of the Code stating that surcharges, penalties and interests applied as a consequence of non compliance with any tax law will not be considered as deductible expenses.

Article Six modifies the scale of rates to be paid by individuals residing in the country, provided for under Article 296 of the Code, establishing that this will be adjusted annually in accordance with accumulated inflation corresponding to the year immediately prior as per the figures published by the Central Bank, as follows:

1. Income from RD$0.00 to RD$240,000.00: Exempted;
2. In excess of RD$240,000.01 up to RD$360,000.00: 15%;
3. In excess of RD$360,000.01 up to RD$500,000.00: 20%;
4. In excess of RD$500,000.01: 25%.

Regarding cash dividends paid to shareholders, whether these are individuals or companies, Article Seven of the Reform modifies Paragraph I of Article 38 of the Code setting forth that the amount withheld by virtue of said provision will constitute a credit against income tax for the company making the distribution. This credit will apply for the fiscal year in which withholding takes place, as long as the amount distributed has paid Income Tax.

With this provision the Tax Authorities are trying to end the practice of using the credit originated by cash dividends paid to shareholders without previously liquidating the income tax on yield obtained.

Also, Article Seven abolishes Paragraph VI of Article 308, on credit transfers of companies with exemption which pay dividends to shareholders.

Another modification established by the Reform is that of Article Eight regarding percentages of gross income established under literals a) and b) of Paragraph I of Article 309, so that the 20% on amounts paid or credited to account for the rental on any type of real state or movable goods, is reduced to 10%, in benefit of the contributor. On the other hand, tax on payments made by the State and its branches, including state corporations and decentralized and autonomous agencies, to individuals and companies, for the acquisition of goods and services in general, not implemented under its authority, will be increased from 1.5% to 2%.

V. Retainer

Under *Article Nine* the Reform modifies, as of fiscal year 2006, provisions set forth under Article 314 regarding Retainers, so that Income Tax contributors (companies) will pay retainers in twelve monthly quotas equivalent to 100% of Income Tax liquidated in previous period.

In this regard, if no Income Tax is liquidated because no profits were obtained, retainers will not be paid because there would be no taxes liquidated, which is the base to calculate them. On the other hand, one would go back to the way in which retainers were calculated up to fiscal year 2000, with the difference that now the same would be collected in twelve (12) equal quotas and before quotas were 50%, 30% and 20% during the sixth, ninth and twelfth months.

In addition, the Reform provides that during fiscal year 2005 companies on account of retainers will pay an amount equal to retainers paid during fiscal year 2004, which will not be subject to any type of deductions on account of credit balances and, in the case of retainers pending payment during the months of 2004, these will be paid in accordance with the system in force before approval of the Reform.

We should point out that application of this new way to calculate retainers will potentially benefit, on one hand, those contributors for whom 25% of Net Taxable Income exceeds the amount paid as retainer, since the DGII will not demand that they (retainer) be paid based on Income Tax liquidated during the year 2004, but rather based on retainers paid during fiscal year 2004, which will benefit the contributor with that situation. On the contrary, will potentially be at a disadvantage those contributors who, at closing of fiscal year 2004, declare losses, since in any case they will have to pay retainers for fiscal year 2005 based on retainers paid during fiscal year 2004.

VI. Tax on Transfer of Industrialized Goods and Services (ITBIS)

Article Ten of the Reform provides that the ITBIS rate is to be increased from a taxable base of 12% established under Article 341 of the Code to 16%. In the case of advertising services, the rate will remain the same, that is 6%, although as of January first of 2005 and until 31 December of the same year, the rate will be increased to 10% and from January 1, 2006, the rate will be increased to 16% equal to that applicable to the rest of the services.

VII. Selective Excise Tax

Article Eleven of the Reform abolishes implementation of tariff 2402.10.00 which corresponds to “cigars, even those without a tip, small cigars which contain tobacco”, while rates for tariffs 2403.10.00 corresponding to “tobacco to smoke as tobacco substitutes in any proportion” and 2403.99.00 relating to “others”, were increased from 65% to 130%.

Also, significant increases were introduced to amounts stated in the table used for the application of this tax to alcohol products, alcohol beverages and beer. In these cases, Selective Excise Tax is independent of any other tax and will not be considered part of the price for the calculation of the taxable base of any other tax.

With regards to the Selective Excise Tax applicable to tobacco products, the taxable base applicable to ITBIS was modified, since before the Reform the Selective Excise Tax was considered part of the taxable base of ITBIS and now it is not.

Significant increases were also introduced to values stated in the table used for application of this tax to cigarettes which contain tobacco.

On the other hand, the fiscal reform provides that values to be used to liquidate Selective Excise Tax for alcohol and tobacco products will be adjusted

according to inflation on a quarterly basis as of the year 2005.

Within the reforms to Selective Excise Tax one of the issues that caused more debates, in view of the approval of the Free Trade Agreement with United States, is the 25% over the sales price by bottling companies of sodas made locally which in their preparation process use sweeteners, syrups with a high content of fructose.

In order to correct the situation, the Executive Power submitted to the National Congress a bill which introduces to the Reform Law an amendment to abolish said tax and, consequently, eliminate any issue which may jeopardize approval of the FTA.

Regarding services levied with the Selective Excise Tax among which are long- distance telephone services, local or international, the Reform in its Twelfth Article reestablishes Articles 381 and 382 of the Tax Code.

Regarding Article 381 of the Tax Code, which establishes a levy of 10% for communication services, the text of the Reform remains the same except that it abolishes the portion that reads: "...that are invoiced in the Dominican Republic or to a broker in the Dominican Republic".

It should be pointed out that this new Selective Excise Tax applied to telecommunications in no way substitutes the 16% pertaining to ITBIS. Therefore, these services will be levied with a total of 28%, including the 2% contribution required by Telecommunications Law No. 153-98.

Article 382 of the Code, after having been repealed by Law 12-01 dated 17 January 2001, creates through Article 12 of the new Reform a tax to payments made through checks and transfers as follows:

Article 382: A tax of 0.0015 (1.5 per thousand) over the value of each check of any nature, whether paid by financial institutions or through the Electronic Clearing House (ACH). Transfers for payments to third party accounts within the same bank will be levied with a tax of 0.0015 (1.5 per thousand). Excluded from this levy are withdrawals from automatic tellers as from banks, consumption through credit cards, Social Security payments, payments of taxes made in favor of the Dominican State, as well as transfers the Government may make of said funds.

This tax will be submitted and paid to the DGII, in the way and conditions established by it.

VIII. Tax on Real Estate on Luxury Housing and Urban Non-constructed Lots

The Reform modifies the first three Articles of Law No. 18-88, in its Thirteenth Article, increasing the exemptions from RD$3,000,000.00 to RD$5,000,000.00 in the case of buildings and created an exemption of RD$5,000,000.00 in the case of urban non-constructed lots.

Real estate affected by this tax according to the Reform are the following:

a) those used as housing whose value exceeds RD$5,000,000.00 including value of the land. It should be noted that previously commercial buildings were not levied by this tax; however, the Reform includes buildings used for commercial, industrial and professional activities.

b) non-constructed lots and buildings which are not used for housing – including those used for commercial, industrial and professional activities – whose value exceeds five million pesos. This new provision benefits contributors since the prior law levied all non-constructed lots regardless of their value.

It is important to note that excluded from this tax are housing whose owners are sixty-five years old or older, as long as it has not change owners during the previous fifteen years and is the only real state owned by that person.

Also, said tax excludes rural land devoted to agriculture, as well as furniture, equipment, machinery, electric generators, merchandise and other movable goods which are located within the properties charged with this tax.

In the case of real estate described under literal b) of Article 13 of the Reform, that is, lots which are owned by companies with organized accounting and which pay income tax, the basis to calculate the tax on real estate on luxury housing and urban non-constructed lots will be the cost of acquisition adjusted by inflation as of the last fiscal year.

In case said company is not operating or the acquisition cost has not been updated, value of the property will be determined by the General Directorate of National Land Registry.

Rate of said tax is 1% of the value of the levied property and will be applied to each property in an independent manner, after deducting the RD$5,000,000.00 exemption.

IX. Inheritance and Grants Tax

Article Sixteen of the Reform set forth that the tax rate on inheritance will be 3% over the value of the sum total of the inheritance, after having made corresponding deductions pertaining to inheritance, this being a significant reduction in the payment of this tax. Previously there was a progressive table for the application of this tax which escalated to 32%.

In the case of grants tax will be 25% of the value of the donation.

Article Seventeen of the Reform repeals Article Five of Law 2569 on Inheritance and Grants, which established a classification in categories of beneficiaries of the transfer of goods due to death.

Article Eighteen modifies the proportional tax to deeds intervened by deeds registrar as of Article Seven, literal d) of Law No. 831 dated 5 March 1945 as follows: "In-kind contributions to equity capital of companies and capital contributions constituted by real estate registered both in the case of formation as well as reorganization of local companies." Therefore, in-kind contributions to local companies will not be levied with the transfer tax; although those to off-shore companies will.

Article Nineteen of the Reform abolishes fiscal exemptions contemplated under Law No. 6-04 dated 11 January 2004, Basic Law of the Housing and Production Development Bank (Banco de Fomento de la Vivienda y Producción). With this provision are abolished a series of fiscal exemptions enjoyed by the Housing and Production Development Bank, previously National Housing Bank (BNV), which also benefited contributors who invested in said institution.

X. Tax on Real Estate Transfers

Article Twenty of the Reform applies a three per cent (3%) tax on real estate transfers over the market value of the property transferred. Also, it applies to real estate transfers that exceed one million pesos, acquired with funds from loans granted by financial institutions; said amount will be adjusted annually to account for inflation.

This represents a significant reduction since before transfer taxes were levied with a 4% tax plus 12% above the 4%. However, it eliminates the exemption applicable to transfers financed through the system of savings and loans.

XI. Tax on Constitution of Commercial Companies

Taxes for the constitution of stock companies, partnership limited by share companies, and joint ventures will be subject to a 0.5% (half of 1%) tax of its authorized equity capital, which cannot be less than RD$1,000.00. Also it will apply in the case of capital increases, representing a significant increase of said tax.

XII. Other Taxes

In accordance with Article Fourteen of the Reform, as of January 1, 2005, all taxes not contemplated within the Tax Code, except revenue stamps, stamps, lids, registers and padlocks which are used for control of local production and import of finished products which have been established at specific values below RD$30.00 will be adjusted and submitted to annual adjustment to account for inflation.

In addition, the same Article establishes that contributors that as of this date have not made the corrections to their capital equity provided for by Law 11-01 in its Article No. 1 can do so up to 31 December 2004 paying one per cent (1%) of the difference of the adjusted equity.

The effect resulting from the correction process of financial statements of companies and sole owner businesses will not generate a fiscal obligation with regards to taxes set forth under the titles that constitute the Code.

Provisions referred to above represent a great opportunity for those contributors who wish to return and declare capitals which are outside the Dominican Republic; as well as those who for one reason or another did not make corrections to their capital equity, as stipulated by Law 11-01 under Article No. 1 in particular, since said corrections to the financial statements will not generate fiscal obligations beyond payment of the 1% required there.

If you wish to acquire a printed copy of this translation please contact Annie Luna at (809) 735-2252 or e-mail: a.luna@phlaw.com

Pellerano & Herrera
Attorneys at law

SANTO DOMINGO
Av. John F. Kennedy No.10
Santo Domingo, Dominican Republic
Apartado Postal 20682
Tel. (809) 541-5200
Fax (809) 567-0773

SANTIAGO
Calle Paseo Oeste, La Rosaleda
Edif. Bionuclear, 1er. Piso
Santiago, Dominican Republic
Tel.: (809) 580-1725
Fax : (809) 582-2170

BAVARO, PUNTA CANA
Plaza Larimar, Local 17
Bávaro, Punta Cana
Dominican Republic
Tel.: (809) 552-1105
Fax: (809) 552-1986

AZUA
Calle Duarte Esq. 19 De Marzo
Edificio Banco Popular, Piso 2
Azua, Dominican Republic
Tel.: (809) 521-2178
Fax: (809) 521-2281

International mailing address:
A-303
P.O. Box 52-4121
Miami, FL 33152-4121
United States of America

www.phlaw.com
ph@phlaw.com