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Legal Update

March 2007

Tax Reform of 2006-2007

Executive Summary: Several laws approved in 2006 and 2007 have introduced important modifications in the Dominican tax and fiscal regimes. The changes include an increase in several taxes and modifications of the rights and obligations of taxpayers.

On December 28th, 2006 the Executive Power signed into law the Law of Fiscal Reform (from here on "LFR"), and was designated as law number 495-06. The LFR was subsequently modified by Law no. 4-07 of January 8th, 2007. According to the considerations outlined in the law, its purpose is to compensate for the loss of customs revenues as consequence of the entry into force of the Dominican Republic - Central America Free Trade Agreement–(DR-CAFTA), executed by and between the United States and the Dominican Republic, as well as other Central American nations.

This most recent reform, as well as others already approved by the Dominican Congress, such as the past tax reforms of 2005 and laws 226-06 and 227-06, which grant functional and administrative autonomy to the Customs Agency and the Internal Revenue Agency, respectively, are part of the commitments assumed by the Dominican Republic as part of the Stand – By Agreement signed with the International Monetary Fund on January 31st, 2005.

Provisions of the LFR include:

1. Establishment of the concepts of "Withholding Agents" and "Collection Agents";

2. Increase of the tax authorities' examination and inspection powers;

3. Creation of new communication channels with taxpayers;

4. Modification of the conditions required to file a tax claim;

5. Establishment of more severe sanctions in case of violations of tax law;

6. Modification of the capital gains tax;

7. Increased regulation of transactions between related parties (Transfer Pricing);

8. Establishment of a Simplified Estimation Regime ("RES" for its Spanish acronym) for certain individual taxpayers;

9. Modification of the percentages to be retained for income tax purposes ("ISR" for its Spanish acronym);

10. Modification of the rate applicable to the Value Added Tax ("ITBIS" for its Spanish acronym);

11. Modification of the luxury goods tax ("ISC" for its Spanish acronym);

12. Increase in the annual tax on vehicle circulation and a new automobile import prohibition;

13. Increase in the tax on sports gambling;

14. Increase in the tax on gambling and lottery games; and,

15. Increase in the fuel tax.

The provisions summarized above will be succinctly explained below, in the same order in which they have been previously presented.

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1. Establishment of the concepts of "Withholding Agents" and "Collection Agents".

Article 1 of the LFR defines the concepts of "Withholding Agents" and "Collection Agents."

The LFR establishes that all persons who because of their public functions, activities or profession, participate in acts or operations in which they are able to carry out the withholding of the appropriate tax are considered to be Withholding Agents.

Therefore, the Withholding Agent must abstain from paying the taxpayer the total sum, in order to place the portion of the tax due directly in the hands of the tax authorities.

On the other hand, the LFR considers to be Collection Agents all persons who, by reason of their profession, activity or function should be in a situation that allows them to receive from the taxpayer, at the moment of receiving any compensation for services provided or the sale of goods, a sum that serves as an advance of the tax that the taxpayer will ultimately be responsible for paying,. Collection Agents have the power to increase to the payment that they receive from the taxpayers the total amount of the tax that they must later place in hands of the tax authorities.

2. Increase of the tax authorities' examination and inspection powers.

Articles 2 and 3 of the LFR grant the Internal Revenue Service the power to request, verify and inspect computer systems where information related to matters of tax are stored. This reform also establishes that the taxpayer must preserve for a period of 10 years ***any electronic documents*** related to the taxpayer's operations or tax matters.

Furthermore, a new formal duty is created for taxpayers: all natural and juridical persons who should perform operations that involve the transfer of goods or services, for profit or otherwise, must issue "tax vouchers" for these operations. This change cements the legal basis of the tax vouchers.

3. Creation of new communication channels with taxpayers.

It will now be possible for the tax authority's notifications to be made by means of electronic mail, fax or any medium of communication, so long as the taxpayer agrees to receive such notices through those means.

On the other hand, the taxpayer will have the possibility, if he or she so desires, of requesting the assignment of a Personal Identification Number (PIN) by the tax authorities, in order to comply, by electronic means, with most of the taxpayer's obligations.

4. Modification of the conditions required to file a tax claim.

Henceforth, in order for a taxpayer to file a judicial claim against the tax authorities, the taxpayer must first exhaust the administrative remedies available against the institution that issued the decision in question.

This modification returns the subject to the situation originally contemplated in the Tax Code: in order for the taxpayer to have the right to file a judicial claim, he or she must have previously exhausted all administrative remedies.

5. Establishment of more severe sanctions in case of violations of tax law.

The LFR substantially modifies the sanctions contemplated by the Tax Code once tax felonies and infractions are discovered, as well as the sanctions corresponding to taxpayers' non-compliance with formal duties. The sanctions have been increased as follows:

INFRACTION	SANCTION
Fraud, when it is not possible to quantify its amount.	Fine in an amount between 5 and 20 month's worth of minimum wages.

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INFRACTION	SANCTION
Production and clandestine Commercialization of goods subject to taxation.	Fine in an amount between 20 and 200 month's worth of minimum wages.
Production and falsification of goods.	Fine in an amount between 30 and 100 month's worth of minimum wages.
Tax evasion, when it is impossible to be quantified.	Fine in an amount between 10 and 20 month's worth of minimum wages.
Non-compliance with taxpayer's formal duties.	Fine in an amount between 5 and 30 month's worth of minimum wages.
Non-compliance with the formal duty of facilitating information to the tax authorities.	In addition to a fine in an amount between 5 and 30 month's worth of minimum wages, a sanction in the amount of 0.25% of income declared in the previous fiscal period may be enforced.
Non-compliance with the duties of corresponding to public officials not part of the tax authorities.	Fine in an amount between 5 and 30 month's worth of minimum wages.

It is noteworthy that these sanctions follow the same pattern of other legislators, including local ones, consisting in using the minimal salary as the basis for establishing sanctions.

6. Modification of the capital gains tax.

The LFR establishes that the goods or rights which are placed or used in the Dominican Republic, as long as the shares of the company who owns them have been transferred and that the company has been incorporated outside of the Dominican Republic, will be considered a sale for tax purposes.

In order to determine the amount of capital gains and the applicable tax rate, the Internal Revenue Agency will estimate the value of the transfer, taking into consideration the value for selling the shares of the company who owns the good or the right, and the proportional value of the good or the right, *vis-à-vis* the global value of the assets of the company whose shares are the subject of the transfer.

With the addition of this paragraph, assets and rights placed in Dominican Republic property of companies incorporated abroad will be considered to have been transferred when the latter have sold their shares.

7. Increased regulation of transactions between related parties (Transfer Pricing).

The objective of this modification is the regulation for tax purposes of transfer prices contracted by and between related parties, and in this manner deal with tax evasion that may occur by manipulating the prices paid in these types of transactions. In this sense, the Internal Revenue Service will now be able to oppose prices that are established between related companies, that is to say, between a local company of foreign capital and an individual or association abroad that has control over the local company.

For the hotel sector, which provides "all included" services, the Internal Revenue Service will be able to define Anticipated Price Agreements (APA), which would be entered into with the National Association of Hotels and Restaurants (ASONAHORES, for its Spanish acronym). To this end, the determination of the applicable prices will be

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based on the zones, an analysis of costs and other important variables.

Finally, the insurance, energy and pharmaceutical sectors will be able to benefit from the same tax treatment as the one granted to the hotel sector.

<u>8. Establishment of a Simplified Estimation Regime ("RES" for its Spanish acronym) for certain individual taxpayers.</u>

Residents of the Dominican Republic will be able to choose either to carry out a global deduction of a thirty percent (30%) of his o her gross income, in order to determine the corresponding personal tax rate applicable, assuming that the following conditions are met: (1) the person must not have an organized accounting system; (2) eighty percent or more of the gross income subject to tax comes from the exercise of professional or related activities; and (3) the income does not exceed an amount of up to seven times the annual tax exemption.

<u>9. Modification of the percentages to be retained for income tax purposes ("ISR" for its Spanish acronym)</u>.

The LFR also modifies some aspects related to withholding of the ISR in the following manner:

REVENUE SOURCE	PREVIOUS WITHOLDING	CURRENT WITHOLDING
Sums paid or credited in an account for the concept of rent or lease of any type of goods, furniture or real estate, of the nature of a payment on account.	20%	10%
On the payments made by the State and its agencies, including state-owned companies and decentralized agencies, to natural and juridical persons, for the acquisition of goods and services in general, not executed in a relation of dependency, of the nature of a payment on account.	1.5%	5%

On the other hand, the sums generated by Pension Fund Administrators, by the broker/dealers in the Stock Market, Administrators of Investment Funds, and securitization companies, are exempted from the above-mentioned withholdings.

<u>10. Modification of the rate applicable to the Value Added Tax ("ITBIS" for its Spanish acronym).</u>

The LFR adds certain goods in the table of exemptions, as well as the exoneration of the payment of said tax to insurance services.

Also, the advertising services, which prior to the publication of the LFR were taxed at a special rate of 6 %, are now taxed at the same rate as all services, namely 16 %.

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11. Modification of the luxury goods tax ("ISC" for its Spanish acronym).

11.1 General Aspects.

The LFR reduces the value of some custom tariffs.

11.2 Insurance Services.

Insurance services are taxed at a 16% rate, taking as taxable basis the fee paid for the insurance.

11.3 Tax on Checks.

The tax on checks amounting to 1.5 thousandths of the amount of a check of any nature remains permanent for those paid by entities of financial intermediation, as well as payments made through electronic wire transfers. Also, the transfers to accounts to third parties, performed within the same bank, are subject to the above-mentioned tax. Cash withdrawals from ATM machines and bank offices are exempted from this tax.

11.4 Alcoholic beverages.

The specific amounts of the ISC applicable for malt beers and other fermented drinks, as well as products derived from ethyl alcohol are modified by the LFR. In addition, alcoholic products or beverages and beers will pay a 15% ad valorem on the retail price as an ISC tax.

11.5 Products derived from tobacco.

On the other hand, cigarette packets of 20 units are taxed at a specific amount of RD$16.82 per packet. Also, packets of 10 units are taxed at a specific amount of RD$8.41. In addition, tobacco products will pay a tax on selective consumption of a 100% ad valorem on the retail price.

12. Increase in the annual tax on vehicle circulation and a new automobile import prohibition.

The reform establishes limits on the importation of automobiles based on their date of manufacture. In this sense, the importation of any vehicles and automobiles whose date of manufacture is greater than the previous five years is prohibited. Likewise, the importation of vehicles weighing more that five tons and whose date of manufacture is greater than the previous fifteen years is also prohibited.

On the other hand, the importation of vehicles whose FOB value is less than US$30,000.00 is exempted from the payment of the import tax.

The LFR also increases the amount of the annual circulation tax on vehicles as follows:

Person	Vehicle manufacture date	Applicable Tax
Companies		
	All	1 % of book value;
Juridical Persons		
	Date of manufacture within previous five years	a) For the first and second years, a payment of a 1% of the value recorded in the first registration. In no case will this payment be less than RD$5,000.00. b) For the third and fourth years, a payment of a 0.75% of the value recorded

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Person	Vehicle manufacture date	Applicable Tax
		in the first registration, which in no case will be less than RD$3,000.00.
	Date of manufacture within the last 5 to 10 years	RD$3,000.00
	Date of manufacture over 10 years	RD$1,500.00

13. Increase in the tax on sports gambling.
The LFR increases by 20% the tax on sports gambling.

14. Increase in the tax on gambling and lottery games.

The LFR imposes an annual tax of thirty one thousand Dominican Pesos (RD$31,000.00) on gambling parlors.

15. Increase in the fuel tax.

The LFR increases the sales tax from 13% to 16%, ad valorem. Additionally, the LFR establishes an additional tax of RD$3.00 per gallon of premium and regular diesel fuel. It also establishes an additional tax of RD$5.00 per gallon of premium and regular gasoline.

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