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GENERAL RULE 07-2011 DESIGNATING AS RETAINING AGENTS LEGAL PERSONS, CORPORATIONS OR COMPANIES ACQUIRING PARTNERSHIP INTERESTS AND SHARES

On July 8, 2011, the National Agency of Internal Revenue (DGII) issued General Rule 07-2011, which designates legal persons acquiring stocks and shares as withholding agents.

According to this Rule, legal persons that acquire shares or partnership interests through legal acts transferring ownership in the property from other individuals or local or foreign companies shall withhold 1% of the sale amount, which is viewed as prepayment of the tax on capital gains that can be generated as a result of the transfer.

The buyer, acting as withholding agent, is required to submit the amount withheld to the DGII no later than the 10th day of the month following payment to the seller.

Exemption from 1% Tax Withholding

If the seller has documentation evidencing that the transfer of partnership interests and shares will not generate capital gain, it may apply directly to the DGII for exemption from withholding. This exemption must be requested not later than 30 days prior to the deadline for the withheld amount payment. However, the time allowed is not compatible with the obligation to pay the withheld amounts no later than the 10th day of the month following the transaction. In case the transaction takes place after the 9th day of a given month and the buyer submits to the DGII the withheld amount no later than the 10th of the next month, the seller will not have the opportunity to request exemption from withholding, because it

will not have the required minimum time specified in the Rule.

Pursuant to the provisions of Article 289 of the Tax Code and Article 13 of the Rule 2-2010, capital gain taxed with the income tax constitutes the difference between the "taxable profit adjusted for inflation" and the selling price or minimum allowable value.

The amount withheld will serve as a tax credit against the seller's tax liability, which will be applied against any tax on capital gain on the sale of stocks or partnership interests.

Purpose of DGII Rule

The purpose of the Rule is to cause 1% of the transfers of shares and partnership interests to be advanced to the Tax Administration as tax payment on the gains resulting from the sales and, thus, to reduce evasion of taxes on the seller's capital gains.

An interesting point, which the Rule 07-2011 does not expressly address, relates to the application of this withholding obligation to foreign companies not registered in the Dominican Republic that acquire stocks and partnership interests. Are these foreign companies required to act as withholding agents?

To answer this question, we take as a basis Article 11 of General Law on Business Associations and Limited Liability Proprietorships No. 479-08 amended by Law 31-11, which states that foreign companies will be required to enroll in the Mercantile Registry if they open a branch or permanent

establishment in the Dominican Republic for the purpose of conducting activities within its corporate purpose on a regular basis or when routinely conducting commercial transactions in the Dominican Republic. It also states that these companies must be registered at the Taxpayers National Registry when, as a result of these activities (i.e., provided that they establish branches or permanent establishments for the purpose of engaging in regular commercial activities in the Dominican Republic), they generate tax liabilities within the national territory. Such registration is required by the current tax laws and regulations.

For its part, Paragraph II of this Article provides that foreign companies are not required to enroll in the Mercantile Registry to be able to conduct occasional or isolated activities, engage in legal proceedings or *invest in stocks or partnership interests*.

Based on these regulations it can be concluded that foreign companies acquiring stocks and partnership interests are not required to act as withholding agents under the provisions of Rule 07-2011.

Failure to pay the withheld amount is subject to the late fees of 10% for the first month or fraction of the month and 4% for each subsequent month or fraction of a month, as well as the 1.73% interest per month or fraction of a month. These penalties are borne by the withholding agent and are not deductible from the income tax.