

McV ALERT
September 16, 2009

**Fortuño Administration Files New
Puerto Rico Tourism Development Act of 2009**

On September 11, 2009, the Fortuño Administration filed through the New Progressive Party majority delegation in the Puerto Rico Legislature, its proposed package of tourism development measures (see our McV Alert on the rest of the package). Among them was House Bill 2026, introducing the new Puerto Rico Tourism Development Act of 2009 (hereinafter “H.B. 2026” or “Proposed Tourism Development Act). The bill also introduces several amendments to the Puerto Rico Internal Revenue Code of 1994 (the “Code”), the Municipal Property Tax Act, the Room Occupancy Rate Tax Act, and the Puerto Rico Tourism Development Act of 1993.

Premises and Objectives

The Proposed Tourism Development Act responds to strategic decisions regarding what should be the public policy of the Government of Puerto Rico. Such public policy includes (1) converting Puerto Rico in a world class tourism destination, (2) promoting adequate conditions to ensure the continuous development and competitiveness of the Puerto Rico hotel industry, (3) providing the environment for the continuous development of local and foreign capital to be invested in tourism projects, (4) adjusting the incentives offered to the Puerto Rican tourism industry for the advancement of better tourism products, overcome the challenges encountered and to take advantage of the opportunities that are currently available, (5) leveling the high costs of construction and of operating tourism businesses in Puerto Rico and (6) taking action to reduce energy costs through different alternatives of renewable energy sources.

Eligible Activities

The definition of tourism activity, and thus, the scope of activities that may enjoy exemption under the Proposed Tourism Development Act, includes:

a. The ownership and administration of (a) hotels, condohotels, Puerto Rican *paradores* (inns), agro-lodgings, time sharing plans and vacation clubs as well as of (b) theme parks, golf courses operated by or associated with a hotel that is itself an exempt business or golf courses located within a resort, regardless of its owner or relationship with another exempt business, tourist marinas, port facilities destined for tourism, agro-tourism, nautical tourism, and other facilities and activities provided the Executive Director of the Puerto Rico Tourism Company (“Director”) determines that such operation is in furtherance of the tourism development of Puerto Rico.

b. The operation of a leasing business engaged in leasing property dedicated to a tourism activity to a business exempt under the Proposed Tourism Development Act.

c. The development and administration of natural resources useful as a source of passive or active entertainment.

Among the new eligible activities are nautical tourism and tourist marinas. Nautical tourism includes, but is not limited to, the following nautical activities when provided to nautical tourists: (1) the leasing or chartering of Nautical Tourism Vessels for leisure, recreation or educational purposes, including excursions; (2) the leasing of small vessels, jet skis, kayaks, sailboats or other similar vessels, whether or not motorized, to guests of a hotel, condohotel, time-share project or vacation club, located within a resort or in a tourist marina or in nearby areas; and (3) the operation of an integrated boat rental program.

Nautical Tourism Vessels are sail or motor boats with a capacity of transporting 6 or more passengers, operated by an excursion company or available for leasing for nautical tourism activities. An integrated boat rental program consists of a business engaged in the rental of sail and motor boats of at least 32 feet, for leisure or recreational purposes. Such vessels must be available for rental under the program for a period no less than 6 months during each year.

Income Tax

Income derived from tourism development as well as dividends or benefits distributed by the exempt business to its shareholders, partners or members, including liquidating distributions of such income shall be exempt from the payment of income taxes as follows: (1) up to 100% if the tourism activity is located in Vieques or Culebra and (2) up to 90% if the tourism activity is located in any other municipality. The exemption shall begin on the day the tourism activity commences, but never before the date of filing of an application for the benefits of the Proposed Tourism Development Act.

The Proposed Tourism Development Act establishes a new withholding tax of 12% on royalties, rental payments or rental rights paid by an exempt business to corporations, foreign partnerships or persons not engaged in trade or business in Puerto Rico. The new withholding tax shall be 2.9% in the event such payments are made to affiliates.

The Proposed Puerto Rico Tourism Development Act establishes that interest paid by a tourism business on account of bonds, loans or other obligations, shall be exempt when the proceeds thereof are used in their entirety for the development, construction, rehabilitation or improvement of an exempt business.

Gains on the sale or exchange of stock or interests in an exempt business or of all or substantially all assets dedicated to a tourism activity of an exempt business will be recognized in the same

proportion as the income from tourism development is subject to the payment of income taxes, to the extent such property continues to be dedicated to a tourism activity for at least 24 months after such sale.

Municipal License, Excise and Other Municipal Taxes

The exemption for new businesses shall be 100%, while the exemption for existing businesses shall be 90%. A special rule applies to contractors and subcontractors to prevent double taxation. The exemption shall commence on January 1st or July 1st closest to the date of filing of an application for the benefits of the Proposed Tourism Development Act.

Guests of an exempt business shall not be subject to municipal license, excise and other municipal taxes on account of their stay as a guest in an exempt business. Also, interest paid by a tourism business on account of bonds, loans or other obligations, shall be exempt when the proceeds thereof are used in their entirety for the development, construction, rehabilitation or improvements of an exempt business.

Municipal Construction Excise Taxes

As a general rule, the exemption shall be applicable for up to 100% of the municipal construction excise taxes imposed. Special rules apply to condohotels. Any dispute with respect to the imposition of the municipal construction excise taxes shall be resolved according to the procedure established by the municipality imposing such tax. The exemption shall commence on the date of filing of the application for the benefits of the Proposed Tourism Development Act.

State and Municipal Real and Personal Property Tax

Businesses exempt pursuant to the Proposed Tourism Development Act shall be up to 90% exempt from the payment of real and personal property taxes with respect to property used in the tourism activity. In the case of existing businesses, the exemption shall commence on January 1st of the year in which an application for the benefits of the Proposed Tourism Development Act is filed. In the case of new businesses, the exemption shall commence on January 1st of the calendar year in which it commences its tourism activity.

Sales and Use Tax (“SUT”)

The exemption shall be up to 100% from the payment of the SUT and excise taxes. The requirement of prior approval by the Puerto Rico Tourism Company for granting the exemption of SUT and excise taxes is eliminated in the case an exempt business acquires personal property outside Puerto Rico to be used in the exempt business. The SUT exemption is applicable when a contractor or subcontractor of an exempt business purchases articles to be used exclusively in a project of an exempt business. The exemption shall commence 30 days after the date of filing of

an application for the benefits of the Proposed Tourism Development Act, subject to prior posting of a bond.

Room Occupancy Tax

The amount received by an exempt business for the sale, exchange, or transfer of the vacation club rights, and the vacation and/or occupancy rights shall be exempt from the payment of the room occupancy tax.

Exemption Period

The exemptions granted under the Proposed Tourism Development Act shall be in effect for a period of 10 years, which period may be extended for an additional 10 years.

Tourism Investment Credit

The Proposed Tourism Development Act provides for a credit for tourism investment equal to 50% of the eligible investment, to be taken in two installments. The maximum amount of credit available to investors shall not exceed 10% of the total project cost, or 50% of the cash contributed by investors, whichever is lowest. The credit may be sold, assigned, or in any other manner transferred, in whole or in part, subject to certain restrictions. The persons authorized to sell, assign or in any other manner transfer a tourism investment credit are broker-dealers, underwriters, partners in an investment partnership, and a lending entity that becomes title holder to the credit through the execution of a lien on said credit. The difference between the credit's face value and its selling price shall be free of tax.

The term "total project cost," for purposes of determining the 10% limitation described above, includes the following: (i) wages paid to employees, land acquisition, construction, habilitation and marketing costs up to the opening date, (ii) pre-opening expenses and expenses associated with the opening ceremony, (iii) payroll, promoting and marketing expenses during the first 12 months of operations, except that an exempt business consisting of a time share or vacation club program may include the promoting and marketing expenses during the first 60 months after the opening of all the facilities of said exempt business; (iv) the interest charges on financing during the first 12 months of operations; (v) hard and soft construction costs incurred in the substantial renovation or expansion of an exempt business; (vi) expenses related to the acquisition of furniture, fixtures, and equipment and operating supplies and equipment during the first 12 months of operation; (vii) expenses related to the issuance of debt to raise capital for the exempt business, (viii) any contingency or reserve account required by any creditor or financial institution, including the Tourism Development Fund; (ix) the acquisition costs or fair market value at the time of contribution, of facilities used in a tourism activity during the 36 months prior to the acquisition or contribution, provided the renovation or expansion exceeds 100% of

the price of acquisition; and (x) any other expense, disbursement or investment as established by the Director through regulations.

Renegotiation of a Concession

An eligible business exempt from taxation under the Puerto Rico Tourism Development Act of 1993, may renegotiate the terms of its concession to enjoy the benefits of the Proposed Tourism Development Act, subject to compliance with certain requirements.

Transfer of an Exempt Business

Upon filing an application of the transfer of an exempt business, the Director shall have up to 60 days after receiving such application to notify its denial in writing or such application shall be considered approved. Certain applications of transfer do not require prior approval.

If you have any questions or comments, or wish additional information regarding the matters discussed herein, please contact any of the attorneys listed below.

Roberto L. Cabañas	787-250-5611	rlc@mcvpr.com
Salvador F. Casellas	787-250-5613	scf@mcvpr.com
Harry O. Cook	787-250-5620	hoc@mcvpr.com
Paul Cortés Rexach	787-250-5630	prcr@mcvpr.com
Alba Joubert	787-250-5649	aj@mcvpr.com
Silvestre Miranda	787-250-2627	smp@mcvpr.com
Rafael Ruiz Ayala	787-250-5668	rar@mcvpr.com
Carlos E. Serrano	787-250-5689	ces@mcvpr.com

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