Kevane Grant Thornton

An instinct for growth™

Tax Alert: New developments on Puerto Rico's tourism industry

Mindful of the importance of tourism activity to Puerto Rico's economic progress and the need to diversify the industry's offerings through the promotion of new products, the development of *niche markets* and the liberalization of requirements for the procurement of tax benefits under the 2010 Puerto Rico Tourism Development Act, the Governor of Puerto Rico signed Acts No. 136 ("Act 136-2016") and No. 137 ("Act 137-2016") on August 5 and 6, 2016, respectively.

Act 136-2016 aims to, among other things, extend tax benefits conferred under the 2010 Puerto Rico Tourism Development Act ("Act 74-2010" or " TDA") to inns and bed & breakfast that have complied with the Puerto Rico Tourism Company ("PRTC") guidelines for ecotourism and sustainable tourism guidelines, and have been certified as such.

For its part, Act 137-2016 amends and/or clarifies various definitions within Section 2 of the TDA. Moreover, it amends Section 5 to enhance the definition of "total project costs", and create an alternate Tourism Investment Tax Credit, among other changes.

Puerto Rico Tourism Development Act of 2010 (Act No. 74 of 2010)

Act 74-2010 provides a series of tax incentives and credits to foster investment and economic growth in Puerto Rico's tourism industry and related infrastructure.

To avail itself of its benefits, the business must be devoted to an eligible tourism activity (as such term is defined in Section 2(a) of Act 74-2010). Furthermore, the business must NOT be covered by a Concession under the 1983 Tourism Incentives Act or the 1993 Tourism Development Act. If the business is deemed an eligible tourism activity, it may become an Exempt Business under the Act by applying for a tax exemption decree before the PRTC and the Puerto Rico Treasury Department.

Amendments under Act 136-2016

***New Eligible Activities*.**

Consistent with its public policy of creating innovative tourism products, the PRTC developed the "Posadas de Puerto Rico" and "Bed & Breakfast". While the former is geared towards highlighting the history and legacy of the urban centers of Puerto Rico, the latter caters to tourists who would prefer a more intimate experience by allowing them to stay at the residence of local family.

Act 136-2016 amends Section 2(a)-1 of Act 74-2010 in order to include the ownership and/or administration of the *Posadas de Puerto Rico* and *Bed and Breakfast* programs as eligible tourism activities. As such, these activities will now be subject to a 7% room occupancy tax under Act 272 No. of 2003.

***Definition of "Existing Business"*.**

Section 2(dd) of Act 74-2010 defines an *existent business* as one engaged in a tourism activity at the time of properly filing an application for a tax exemption decree under Act 74-2010 or which otherwise does not qualify as a *new business* under Act 74-2010, and which undertakes a substantial extension or renovation of the existing physical facilities to be used in the tourist activity.

Contact us
For assistance in this matter, please contact us via
maria.rivera@pr.gt.com
francisco.luis@pr.gt.com
lina.morales@pr.gt.com
isabel.hernandez@pr.gt.com

September 21, 2016

Act 136-2016 opens a 12-month window for existing *small* or *medium guest houses*, who are not covered by a tax exemption decree, to apply for the preferential tax treatment under Act 74-2010 without having to carry out a substantial extension or renovation of the existing physical facilities, subject to the PRTD Executive Director's discretion and approval.

To be considered a *small* or *medium guest house*, a business must be a tourism activity that has become an eligible business after the issuance of a tax exemption decree, belongs to either the *Posadas de Puerto Rico* or *Bed and Breakfast* program and, depending on the number of rooms, complies with the definitions found on Act 74-2010 for a guesthouse [Sec. 2(d)] or a hotel [Sec. 2(s)].

Tourism Investment Tax Credits. Pursuant to Section 5 of Act 74-2010, any person who acquires an equity interest in a corporation or a partnership that develops an exempt tourism business, or who invests in a condohotel, will be entitled to a **Tourism Investment Tax Credit ("TITC")** equal to 50% of the cash paid for such equity investment. Nonetheless, the total amount of the TITC which may be taken by all investors cannot exceed 10% of the total cost of the tourist project.

Act 136-2016 effectively amends Section 5(c)(1) of the TDA to establish a separate tax credit threshold for inns that have been certified by PRTC as ecotourism or sustainable tourism locations. Namely, the maximum TITC allowed for these entities will be the lower amount between 20% (instead of 10%) of the Total Project Cost and 60% (instead of 50%) of the cash contributed by investors (i.e. "Eligible Investment").

Sales and Use Tax ("SUT") Exemption. According to Section 3(a)(4) of Act 74-2010, exempt businesses enjoy up to 100% exemption from the payment of the taxes imposed under Subtitle B and BB of the 1994 Puerto Rico Internal Revenue Code ("1994 Code") with respect to those items acquired and used by the exempt business in connection with its exempt tourism activity.

Act 136-2016 clarifies the application of the exemption to the SUT imposed by the 2011 Internal Revenue Code for a New Puerto Rico ("2011 Code") under Subtitles C, D, DD and DDD , and eliminates a particular reference to the application of the SUT exemption in the case of time-shares and vacation clubs.

Also, fuel products used by the exempted business in the generation of electricity or thermic energy for its tourism activity will be fully exempted from taxes imposed under Sections 3020.07 and 3020.07(A) of the 2011 Code. This exemption will last for a period of ten (10) years.

Amendments under Act 137-2016

As note before, Act 137-2016, also known as the *TOURISM INDUSTRY SUPPORT ACT*, seeks to facilitate the development and growth of PR's tourism industry by expanding some of Act 74-2010 benefits for particular instances. It also intends to be a new employment-generating force through the creation of the Tourism Industry Investment and Recovery Program.

Under this new legislation, Section 2 of Act 74-2010 is amended to, among other things, allow costs incurred on mixed-use development projects as part of the Total Project Cost, so longs as no less than 70% of the total project area is destined to tourism, excluding common elements.

Act 137-2016 also amends Section 5 of the TDA to introduce the **Alternate Tourism Investment Tax Credit** ("ATITC"), which will be equal to:

- **Section 5(b)(1) Option** - 40% of the Eligible Investment made after the enactment of Act 137-2016. This credit can be taken in three (3) equal installments, commencing on the Exempt Business' second year of operations.

OR

- **Section 5(b)(2) Option** – 30% of the Eligible Investment made after the enactment of Act 137-2016. In this case, the Exempt Business can take 10% of said Eligible Investment as a credit on the year that it secured the financing for the construction of the tourism project, with remaining balance being taken in three (3) equal installments:

  - 1/3 when the Exempt Business receives its first paying guest; and
  - The remaining 2/3 on subsequent years, in equal 1/3 portions.

The total amount of ATITC's available to the Exempt Business under Sections 5(b)(1) and (2) will be limited to the 40% and 30%, respectively, of the Total Project Cost, as such term is defined in Sec. 2(j) of the TDA.

As with regular TITC's, ATITC's can be used against the Investor's or Exempt Business' own tax liability, and/or be transferred to a third party pursuant to the provisions of the TDA. Nonetheless, in the case of ATITC's, its transfer or sale is subject to the following limitations:

- ATITC's under Section 5(b)(1) – once the construction and development of the tourism activity is completed and the PRTC's Executive Director certifies the final and total credit amount;
- ATITC under Section 5(b)(2) – once the Exempt Business certifies to the PRTC that it has secured the financing for the complete construction of the tourism project, an initial 10% of the Eligible Investment will be made available. The remaining balance will be available once the project is finalized and the PRTC's Executive Director issues a certification to that end.

Also, proceeds from the sale of ATITC's must be used in particular order:

1. Repayment of loans provided by any financial institution or government entity, including, without limitation, the Puerto Rico Tourism Company, its subsidiary, the Hotel Development Corporation, and the Economic Development Bank of Puerto Rico;
2. Repayment of any other loans granted to the Exempt Business to defray the Total Project Cost.

Acts 136 and 137 represent the first major amendments to the original text of Act 74-2010. By including new types of tourism accommodations as Eligible Businesses and creating new avenues for the procurement of tax credits, the PRTC is striving to keep up with changing times and exploit new markets for the well-being of the Puerto Rico economy.

Please contact our Tax Department should you require additional information regarding this or any other tax issue. We will be glad to assist you.