



# Overview of Proposed Puerto Rico Opportunity Zone and Economic Development Incentives Act



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# PR Qualified Opportunity Zone Program

## Summary

- The proposed Puerto Rico Opportunity Zone and Economic Development Incentives Act (OZEDIA or PR QOZ Program) was introduced in October 2018 by the PR Legislature.
- The proposed OZEIDA aims to make Puerto Rico opportunity zone investments more attractive by providing tax incentives to business activities that generally have not been incentivized in the past, and provides PR investors the same federal tax benefits for investing eligible gains in opportunity zone funds conducting activities in Puerto Rico.
- Entities operating under the PR QOZ Program would benefit from a reduced corporate income tax rate, full exemption on dividend distributions, and partial exemptions from municipal license tax (MLT), personal and real property taxes and construction excise tax as well as the ability to generate transferable income tax credits, among others incentives.

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## OZ Fund Certification Process and Eligibility Criteria

- The proposed OZEDIA would apply to an Opportunity Zone Fund (OZ Fund), or to an entity in which the OZ Fund invests (OZ Sub), that qualifies under Section 1400Z-2 of the US Internal Revenue Code of 1986, as amended (US-IRC), and that conducts a business that is a “priority project” in an “eligible zone” in Puerto Rico (OZ Eligible Business Activities).
- The proposed OZEDIA defines the term “priority project” as one that will contribute to the economic recovery, diversification and transformation of Puerto Rico as approved by the Opportunity Zone Committee (OZ Committee) and the Governor of Puerto Rico, and an “eligible zone” as an Opportunity Zone (OZ) under US-IRC Section 1400Z-1(b)(3) and designated as such by the OZ Committee.
  - The OZ Committee is a committee that would be established by the proposed OZEIDA and is comprised of the person in charge of the CFO role established by Executive Order OE-2013-007, the person in charge of the CIO role established by Executive Order OE-2018-035, the Executive Director of the Puerto Rico Fiscal Agency & Financial Advisory Authority (FAFAA), and two additional members, one of which is appointed by the PR Senate and another one by the PR House of Representatives.
- The proposed OZEDIA also provides that any OZ Fund, or OZ Sub, must first request a meeting with the OZ Committee as a condition precedent to filing an application to obtain tax incentives under the PR QOZ Program. The OZ Fund, or OZ Sub, will be required to provide the OZ Committee with a detailed description of the proposed OZ Eligible Business Activities, including the location of the activities, the expected amounts to be

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## OZ Fund Certification Process and Eligibility Criteria (cont'd)

- The tax incentives under the proposed OZEDIA will be granted by way of a tax decree between the OZ Fund, or the OZ Sub, or both, and the Government of Puerto Rico (QOZ Decree). The QOZ Decree will be issued for a 15-year term, and may be renegotiated for an additional term to be established by regulations to be issued by the Secretary of the Puerto Rico Department of Economic Development and Commerce.
- Business activities that qualify for tax incentives under Act 73-2008 (manufacturing), Act 74-2010 (tourism), Act 83-2010 (green energy), Act 27-2011 (film industry), and Act 20-2012 (export services), do not qualify as OZ Eligible Business Activities and are not eligible for tax incentives under the proposed OZEDIA.

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## Tax Incentives for QOZ Decree Holders

- The proposed OZEDIA provides OZ Funds, or OZ Subs, with a valid QOZ Decree (QOZ Decree Holders) with the following tax incentives:
  - 20% corporate income tax rate on net income earned from the OZ Eligible Business Activities in lieu of any other taxes on income;
  - 20% withholding tax on payments made to nonresident corporations or partnerships or other nonresident persons not otherwise engaged in a Puerto Rico trade or business, for the use of intellectual property in the OZ Eligible Business Activities;
  - capital gains tax exemption on gains realized from sale of assets during term of the QOZ Decree, if the QOZ Decree Holder reinvests the proceeds in compliance with US-IRC Section 1400Z-2(d)(1);
  - 50% MLT exemption on gross income earned from OZ Eligible Business Activities, or 75% MLT exemption on gross income earned from OZ Eligible Business Activities treated as “eligible residential priority projects”;
    - An “eligible residential priority project” is any priority project located in an eligible zone that has an important social interest housing component, as determined by the OZ Committee.
  - 50% personal and real property tax exemption on property used in the OZ Eligible Business Activities, or 75% personal and real property tax exemption on property used in “eligible residential priority projects”; and
  - 75% exemption on construction excise taxes associated to the OZ Eligible Business

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## Tax Incentives for QOZ Decree Holders (cont'd)

- In addition, the proposed OZEDIA exempts from income tax and MLT (i) interest paid on debt instruments of a QOZ Decree Holder held for the development, construction, rehabilitation, or improvements of OZ Eligible Business Activities, or (ii) interest paid by a QOZ Decree Holder on existing loans, to the extent the proceeds from such loans originally were used in their entirety for the development, construction, rehabilitation, or improvements of OZ Eligible Business Activities.
- For the interest income to be exempt under the proposed OZEIDA, the debt instrument must be issued directly by the QOZ Decree Holder.

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## PR Tax Credits

- The proposed OZEDIA grants investment tax credits to investors for investments that QOZ Decree Holders make in OZ Eligible Business Activities (QOZ Tax Credits). Although the QOZ Tax Credits will ultimately be allocated to the investors in the OZ Fund, the QOZ Tax Credits will be fixed by the OZ Committee at the level of the OZ Fund, or OZ Sub.
- QOZ Tax Credits will not exceed 15% of the cash capital contributions the investors make to the OZ Fund, or the OZ Sub.
- The proposed OZEDIA requires the OZ Fund to allocate the QOZ Tax Credits to the investors in whatever proportion agreed upon by the investors and the OZ Fund (QOZ Tax Credit Allocations) and to notify the PR Treasury Department of the QOZ Tax Credit Allocations.
- The investors may use their QOZ Tax Credits in two installments, one in the year where the OZ Fund, or OZ Sub, obtains the necessary financing for establishing the OZ Eligible Business Activities or the construction of the OZ Eligible Business Activities, and the other one in the following year. The Act further provides that investors may carry forward any unused QOZ Tax Credits indefinitely, and may sell, transfer or dispose the QOZ Tax Credits once the QOZ Tax Credit Allocations have been notified to the PR Treasury Department.
- Lastly, and more importantly, the proposed OZEIDA provides that the QOZ Tax Credits may be used to offset all taxes on income imposed by the PR Internal Revenue Code of 2011, as amended (PR-IRC), as well as any other taxes imposed by Act 399-2004, Act 73-2008, Act 74-2010, Act 83-2010, Act 20-2012, and Act 273-2012.



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## Additional Considerations

- If the OZ Fund fails to meet the 90% investment requirement per US-IRC Section 1400Z-2(f), and is subject to the penalties imposed by such Section, the OZ Fund will be required to pay a penalty of equal amount to the PR Treasury Department with the OZ Fund's PR income tax return corresponding to the year in which the penalty was imposed.
- Also, any OZ Fund, or OZ Sub, that is treated as a disregarded entity for US federal income tax purposes will be respected as a disregarded entity for PR income tax purposes (i.e., it will not be treated as a partnership under the PR-IRC). In addition, any OZ Fund, or OZ Sub, that would otherwise be treated as a partnership under the PR-IRC, will be treated as a corporation for PR income tax purposes. The PR Treasury Department will issue regulations or other guidance to this effect.

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## Tax Incentives for PR Resident Investors

- The proposed OZEDIA would amend the PR-IRC to include a provision that mirrors US-IRC Section 1400Z-2.
- PR residents would also enjoy a temporary deferral on gains from the sale of capital assets to unrelated persons to the extent they invest all or a portion of such gain (Rolled-Over Gain) in an OZ Fund that conducts eligible business in Puerto Rico within 180 days from the date the gain is realized. The deferral period will end on the earlier of the date of disposition of the investment in the OZ Fund, or December 31, 2026.
- Further, if the PR resident holds its investment in the OZ Fund for at least five years, it would receive a step-up in basis equal to 10% of the Rolled-Over Gain; if the PR Resident holds its investment in the OZ Fund for at least seven years, the PR Resident would receive an additional step-up in basis equal to 5% of the Rolled-Over Gain, for a total step-up in basis of 15% of the Rolled-Over Gain. This means that if a PR Resident invests its Rolled-Over Gain in an OZ Fund on or before December 31, 2019, and holds its investment in the OZ Fund on December 31, 2026, the PR Resident would be subject to PR income tax only on 85% of the Rolled-Over Gain.
- Lastly, if the PR resident that invested its Rolled-Over Gain in an OZ Fund holds its investment for at least ten years, the PR resident's basis in its investment in the OZ Fund will equal its fair market value on the date it disposes its interest in the OZ Fund, and no gain will be realized.

# PR Qualified Opportunity Zone Program

## Expedited Permitting Process

- To facilitate implementation of a “priority project” within the limited time frame available to benefit from an OZ Fund, the proposed OZEDIA would establish a special expedited permitting process.
- Under this proposed mechanism, the permits, licenses, franchises, “consultas” or certifications necessary to develop a “priority project” would have to be processed in specified reduced time frames (e.g., 10 working days to obtain agency comments, 30 working days to process a “consulta” approval and 10 working days to process other development permits).
- The proposed OZEDIA would also require that all of these permits be evaluated and processed by the Office of Management of Permits (OGPe) regardless of the location of the project or the existence of a Hierarchies Transfer Agreement (“Convenio de Transferencia de Jerarquías”) with a Municipality, thereby consolidating the process in the central government.
- In addition, the review and final determination related to environmental documents would be under the jurisdiction of an Environmental Compliance Interagency Subcommittee, appointed by the Governor. This entity would be required to process environmental documents (e.g., environmental assessments and environmental impact statements) in a period of 20 working days (extendable to 45 days in extraordinary circumstances).
- Expedited/simplified procedures for challenging a permit decision would also be established, which would include providing as sole remedy for this challenge the filing of a request for judicial review, reducing the time frame to request this remedy and precluding stays of challenged actions other than in exceptional circumstances.

# Thank you

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