



GOBIERNO DE PUERTO RICO

Departamento de Hacienda

November __, 2019

ADMINISTRATIVE DETERMINATION NO. 19-__

ATTENTION: ENTITIES ENTERING INTO OPERATION AND MAINTENANCE PARTNERSHIP CONTRACTS WITH A PARTNERING GOVERNMENT ENTITY UNDER ACT 29-2009, AS AMENDED, OR ACT 120-2018, AS AMENDED

SUBJECT: CERTAIN RULES AND TAX CONSIDERATIONS APPLICABLE TO A CONTRACTOR THAT ENTERS INTO A PUBLIC-PRIVATE PARTNERSHIP CONTRACT WITH A PARTNERING GOVERNMENT ENTITY FOR THE OPERATION AND MAINTENANCE OF A FUNCTION, SERVICE OR FACILITY

I. Statement of Motives

Act 29-2009, as amended, known as the Public Private Partnership Act (“**Act 29**”) sets forth the public policy regarding public private partnerships in Puerto Rico and creates the legal framework for the establishment of such partnerships. Pursuant to the provisions of Act 29, any Partnering Government Entity is authorized to establish a Partnership and execute a Partnership Contract in connection with any Function, Service or Facility, as such terms are defined under Act 29. Act 120-2018, as amended, known as the Act to Transform Puerto Rico’s Electric System (“**Act 120**”), authorized the establishment of Partnerships in connection with any Function, Service or Facility of the Puerto Rico Electric Power Authority pursuant to the legal framework established in Act 29.

The purpose of this Administrative Determination is to set forth certain rules and tax considerations applicable to a private contracting entity that enters into an Operation and Maintenance Partnership Contract under Act 29 or Act 120 with a Partnering Government Entity for the operation and maintenance of a Function, Service or Facility.

II. Definitions

The following terms will have the meanings set forth herein for purposes of this Administrative Determination:

1. “**Contractor,**” “**Partnering Government Entity,**” “**Function,**” “**Service**” and “**Facility**” – have the same meaning set forth in Act 29.

2. **Management Fees** – the fees paid by a Partnering Government Entity to a Contractor as compensation for the services it provides under an Operation and Maintenance Partnership Contract in connection with the operation and maintenance of a Function, Service or Facility. It excludes the costs incurred by the Contractor on behalf of the Partnering Government Entity in the operation and maintenance of a Function, Service or Facility.
3. **Operation and Maintenance Partnership Contract** – a contract entered into with a Partnering Government Entity under Act 29 or Act 120 for the operation and maintenance of a Function, Service or Facility which provides that the Partnering Government Entity Fees will remain the property of the Partnering Government Entity.¹
4. **Partnering Government Entity Fees** – the fees or charges imposed by the Partnering Government Entity that are collected by the Contractor (or another agent of the Partnering Government Entity) under an Operation and Maintenance Partnership Contract on behalf of the Partnering Government Entity from the third-party customers or users of the Function, Service or Facility being administered and operated by the Contractor.²
5. **Pass-Through Expenditures**– the costs and expenses, without including a profit margin, incurred by a Contractor on behalf of the Partnering Government Entity in the course of providing services under an Operation and Maintenance Partnership Contract in connection with the operation and maintenance of a Function, Service or Facility that are paid from the Partnering Government Entity Fees collected by the Contractor (or another agent of the Partnering Government Entity) or from other sources, including legislative appropriations.
6. **Termination Payment** – the payment made by a Partnering Government Entity to a Contractor in connection with the termination of an Operation and Maintenance Partnership Contract.

III. Determinations

(A) Treatment of Management Fees and Termination Payments Made to a Contractor

Article 12(a) of Act 29 provides that the Contractors of an Operation and Maintenance Partnership Contract are subject to a twenty (20) percent fixed income tax rate on the net income derived from the operations set forth in the Operation and Maintenance Partnership Contract, computed in accordance with the Puerto Rico Internal Revenue Code of 2011, as amended (the “**PR Code**”). Article 12(a) of Act 29 further provides that the twenty (20) percent fixed income tax rate applies in lieu of any other income tax, if any, imposed under the PR Code or any other law including, but not limited to, the alternative minimum tax and the tax on the deemed dividend amount imposed under the PR Code. In addition, Article 12(a) of Act 29 provides that the owners of the Contractor

¹ This Administrative Determination does not apply to any contract or to any portion of any contract executed pursuant to Act 29 in which the Partnering Government Entity Fees are collected and retained by the Contractor, with such fees legally belonging to the Contractor (rather than to the Partnering Government Entity).

² For example, those would include the fees paid by customers of a utility service and the users of a transportation service.

will not be subject to the payment of income taxes on dividend distributions of the net income derived from the operations covered under an Operation and Maintenance Partnership Contract.

Based on the above, the net income derived by a Contractor with respect to the Management Fees³ under an Operation and Maintenance Partnership Contract will be subject to a twenty (20) percent fixed income tax rate. Moreover, for Puerto Rico income tax purposes, the net income derived by a Contractor with respect to a Termination Payment under an Operation and Maintenance Partnership Contract will be considered to be derived from the operations provided in the Operation and Maintenance Partnership Contract and, accordingly, to the extent that all or a portion of it is considered ordinary income, will be treated as net income derived from the operations covered by the Operation and Maintenance Partnership Contract subject to the twenty (20) percent fixed income tax rate provided under Article 12(a) of Act 29. Furthermore, neither the Management Fees nor the Termination Payment will be subject to the alternative minimum tax imposed under Section 1022.03 of the PR Code or the ten (10) percent deemed dividend tax imposed under Section 1062.13 of the PR Code. Finally, the owners of the Contractor will not be subject to the payment of income taxes on dividend distributions of the net income derived from the operations covered under the Operation and Maintenance Partnership Contract.⁴

(B) Treatment of the Partnering Government Entity Fees

As part of its duties and responsibilities under an Operation and Maintenance Partnership Contract, the Contractor may be required to collect (on behalf of the Partnering Government Entity) from third party customers or users the fees or charges imposed on such customers or users in connection with the provision of the Function, Service or Facility being administered and operated by the Contractor, which the Partnering Government Entity formerly collected from third party customers or users prior to the execution of the Operation and Maintenance Partnership Contract. In these cases, the Contractor is merely acting as an intermediary between the Partnering Government Entity and third-party customers or users in the collection of such fees and the Partnering Government Entity Fees legally belong to the Partnering Government Entity (with the Partnering Government Entity being considered the owner of the Partnering Government Entity Fees under the Operation and Maintenance Partnership Contract) and, accordingly, there is no accession to wealth to the Contractor. Therefore, the Partnering Government Entity Fees collected by the Contractor under an Operation and Maintenance Partnership Contract on behalf of the Partnering Government Entity from third-party customers or users in connection with the Function, Service or Facility being administered and operated by the Contractor will not be considered gross income or revenues of the Contractor and the Contractor will not be subject to Puerto Rico income taxes with respect to such fees.

³ The management fees may be a fixed fee, a variable fee or an incentive fee, or a combination of these.

⁴ This Administrative Determination does not apply to a concession, lease or other form of contract with respect to a Function, Service or Facility entered into under Act 29 under which the private contractor has the right to retain the revenues collected from such Function, Service or Facility. For certain rules and considerations applicable to such contracts, see Administrative Determination No. 19-_____.

(C) Treatment of Pass-Through Expenditures

In some Operation and Maintenance Partnership Contracts, the Partnering Government Entity is required to make payments to the Contractor in order to cover the Pass-Through Expenditures incurred by the Contractor on behalf of the Partnering Government Entity. Such payments constitute reimbursements for the costs incurred by the Contractor on behalf of the Partnering Government Entity in order to fulfill its obligations under the Operation and Maintenance Partnership Contract and will not be considered gross income or revenues of the Contractor.

In general, a taxpayer is allowed to deduct all the ordinary and necessary business expenses paid or incurred during the taxable year in carrying on a trade or business, as per Section 1033.01 of the PR Code. However, a taxpayer is not allowed a deduction for expenditures for which it has a fixed right or expectation of reimbursement from another party for an expense paid on behalf of that party. Furthermore, the reimbursement payment of an otherwise deductible expenditure incurred is not taxable to the taxpayer.

Based on the above, (i) the Contractor will not be entitled to deduct as ordinary and necessary business expenses under Section 1033.01 of the PR Code the Pass-Through Expenditures incurred by the Contractor on behalf of the Partnering Government Entity pursuant to the Operation and Maintenance Partnership Contract, and (ii) the Contractor will not be required to include as gross income or revenues and will not be subject to income taxes under the PR Code with respect to the payments made by the Partnering Government Entity to the Contractor in order to reimburse the Pass-Through Expenditures incurred by the Contractor under the Operation and Maintenance Partnership Contract.

(D) Deduction of Expenses Between Related Parties

Section 1033.17(a)(17) of the PR Code provides that fifty-one (51) percent of the expenses incurred by a taxpayer and paid or to be paid to: (i) a related person not engaged in a trade or business in Puerto Rico, if such expenses are attributable to the conduct of a trade or business in Puerto Rico and not subject to tax or withholding at source under the PR Code in the taxable year in which they were incurred or paid, or (ii) a home office located outside of Puerto Rico, by a foreign corporation engaged in trade or business in Puerto Rico through a branch, are not allowed as deductions in computing the net taxable income (the “**51% Expense Disallowance**”). Section 1033.17(a)(16) of the PR Code similarly provides for the 51% Expense Disallowance in the case of entities taxable as partnerships under Chapter 7 or under Subchapters D or E of Chapter 11 of Subtitle of the PR Code. Furthermore, Sections 1033.17(a)(17)(C) and 1033.17(a)(16)(D) of the PR Code provide that the 51% Expense Disallowance does not apply to persons that operate under the provisions of Act 73 of May 28, 2008, known as the Puerto Rico Development Economic Incentives Act, or any other similar preceding or succeeding act, or under the provisions of Act 74 of July 10, 2010, known as the Puerto Rico Tourist Development Act of 2010, Act 83 of July 19, 2010, and Act 20 of January 17, 2012, or any other similar preceding or succeeding act, or of any other special statute that grants a tax exemption with respect to income derived from the operations covered under a decree, resolution or concession of tax exemption conferred under such acts.

As mentioned above, the 51% Expense Disallowance does not apply to entities enjoying a preferential income tax treatment under a tax incentives law or under any other similar or special statute that granting tax exemption. Act 29 is a special statute pursuant to which the net income derived from the activities covered under an Operation and Maintenance Partnership Contract is subject to a preferential twenty (20) percent fixed income tax rate, which from a practical point of view results in the granting of a partial exemption on the net income derived by the Contractor (considering that the maximum ordinary corporate income tax rate amounts to thirty-seven and a half (37.5) percent). Accordingly, it is determined herein that a Contractor that enters into an Operation and Maintenance Partnership Contract with a Partnering Government Entity will not be subject to the 51% Expense Disallowance provided under Sections 1033.17(a)(17) and 1033.17(a)(16) of the PR Code, since the Contractor will be considered to be covered under a special statute that grants tax exemption with respect to income derived under the Operation and Maintenance Partnership Contract.

(E) Applicability of Sales and Use Taxes

(i) Acquisition of Taxable Items

In general, every merchant engaged in any business in Puerto Rico that sells taxable items is responsible to collect the sales and use tax (the “SUT”) based on the sales price of the item, as per Sections 4020.01, 4020.02, 4210.01 and 4210.02 of the PR Code.

Notwithstanding the above, Section 4030.08(a) of the PR Code provides that every “taxable item” acquired for official use by the agencies and instrumentalities of the Government of the United States of America and the Government of Puerto Rico are exempt from the payment of the SUT. Furthermore, the term “Government of Puerto Rico” is defined for these purposes as the departments, agencies, administrations, bureaus, boards, commissions, offices, public corporations, public instrumentalities and the municipalities of the Government of Puerto Rico, including the Legislative Branch and the Judicial Branch, with such term also including those persons operating or acting on behalf or in the name thereof, as provided in Section 4010.01(p) of the PR Code.

Consistent with the above, Article 4030.08-1(a)(2) of the Regulations under the PR Code provides that the term “Government of Puerto Rico” (and the Government of the United States of America) includes those persons that operate or act on their behalf, requiring that such persons request and obtain a certificate to those effects from the Secretary of the Treasury (the “Secretary”). The referenced certificate issued by the Secretary will generally be effective for a two (2) year period. Article 4030.08-1(a)(2) of the Regulations under the PR Code further provides that the person requesting the referenced certificate to act on behalf of the Government must provide to the Secretary evidence to the effect that the entity was created exclusively to act in an official capacity as an agent of the Government. In addition, the person must provide a certification issued by the governmental entity in the name of which the entity is acting in which such authority is acknowledged, as well as a list of the taxable items to be acquired on the governmental entity’s behalf.

Based on the above, it is determined herein that a Contractor that enters into an Operation and Maintenance Partnership Contract with a Partnering Government Entity will be considered to be operating or acting on behalf or in the name of the Partnering Government Entity with respect to the taxable items that the Contractor is required to acquire on behalf of the Partnering Government Entity in order to fulfill its obligations under the Operation and Maintenance Partnership Contract (the “**Covered Items**”). Accordingly, the acquisition of such Covered Items by the Contractor will not be subject to the payment of the SUT, as per Section 4030.08(a) of the PR Code even if such Covered Items become the property of the Contractor. The Contractor should request and the Secretary will issue the certificate referred to in Article 4030.08-1(a)(2) of the Regulations under the PR Code evidencing that the Contractor is operating or acting on behalf or in the name of the Partnering Government Entity, which will be effective for the same term of duration of the Operation and Maintenance Partnership Contract (rather than for a two (2) year period). The Partnering Government Entity will also certify to the Secretary the classes of items that qualify as Covered Items. Any item acquired by the Contractor that becomes the property of the Partnering Government Entity will automatically qualify as a Covered Item exempt from the payment of the SUT even if it is not included in the certification provided by the Partnering Government Entity.

However, the taxable items acquired by the Contractor that will become property of the Contractor and that are not required to be acquired under the Operation and Maintenance Partnership Contract (i.e. they are not required to be acquired on behalf of the Partnering Government Entity in order to fulfill its obligation under the Operation and Maintenance Partnership Contract) will not be covered by the tax exemption granted under Section 4030.08(a) of the PR Code and, accordingly, will be subject to the payment of the SUT. Although the Contractor is empowered through the Operation and Maintenance Partnership Contract to perform a key governmental function, the SUT exemption for taxable items acquired by the Government of Puerto Rico established in Section 4030.08(a) of the PR Code will not be applicable to the acquisition by the Contractor of taxable items which are typically acquired as part of conducting regular business operations in Puerto Rico.

(ii) Partnering Government Entity Fees

The Partnering Government Entity Fees constitute fees or charges that are imposed by the Partnering Government Entity (rather than by the Contractor) pursuant to applicable legislation. These fees or charges are subject to the provisions of the Operation and Maintenance Partnership Contract that provides consent rights or oversight over such fees or charges to the Partnering Government Entity, with the Contractor merely acting as an intermediary in the collection of a fee or charge legally imposed pursuant to applicable legislation. These charges imposed by the Partnering Government Entity and collected from third party customers or users prior to the execution of the Operation and Maintenance Partnership Contract are not currently subject to the payment of the SUT. For example, pursuant to Section 4010.01(1)(2) of the PR Code, the amount paid to admit a person or vehicle into the collective transportation systems established by the Government of Puerto Rico, such as the Metropolitan Bus Authority, the Ports Authority and the Transportation and Public Works Department, or by an operator or subcontractor, including persons certified by the Government of Puerto Rico, its agencies or instrumentalities to render those services, are not subject to the payment of the SUT. Similarly, the charges or fees paid by customers of a utility service (such as electricity from the Puerto Rico Electric Power Authority or

water from the Puerto Rico Aqueduct and Sewer Authority) are not subject to the payment of the SUT, in accordance with Section 4010.01(gg)(2) of the PR Code.

Based on the above, considering that the Partnering Government Entity Fees are legally imposed by the Partnering Government Entity, with the Partnering Government Entity retaining control or oversight of the referenced fees at all times, such fees should not be subject to the payment of the SUT. Accordingly, the fees and charges imposed on the customers and users of the Service will not be subject to the payment of the SUT, irrespective of whether the Partnering Government Entity Fees belong to the Partnering Government Entity or to the Contractor.

(iii) Examples

Example 1:

Contractor X enters into an Operation and Maintenance Partnership Contract with a Partnering Government Entity in order to administer and operate a Service. In order to fulfill its obligations under the Operation and Maintenance Partnership Contract, Contractor X acquires in Puerto Rico certain parts and accessories to be used to repair and maintain certain equipment belonging to the Partnering Government Entity which are used in providing the Service covered under the Operation and Maintenance Partnership Contract. The Contractor also collects on behalf of the Partnering Government Entity from third-party customers or users certain fees or charges imposed on such customers or users in connection with the provision of the Service, which the Partnering Government Entity directly collected from third party customers or users prior to the execution of the Operation and Maintenance Partnership Contract. Contractor X requested and the Secretary issued to Contractor X the certificate referred to in Article 4030.08-1(a)(2) of the Regulations under the PR Code evidencing that Contractor X is operating or acting on behalf or in the name of the Partnering Government Entity. The parts and accessories qualify as Covered Items because they will become part of a property belonging to the Partnering Government Entity. The acquisition of the referenced parts and accessories by Contractor X is not subject to the payment of the SUT. In addition, the fees or charges paid by the third-party customers or users in connection with the provision of the Service constitute Partnering Government Entity Fees that are not subject to the payment of the SUT.

Example 2:

Contractor X enters into an Operation and Maintenance Partnership Contract with a Partnering Government Entity in order to administer and operate a Service. After entering into the Operation and Maintenance Partnership Contract, Contractor X acquires in Puerto Rico certain office equipment to be used by its executives in the rendering of services under the Operation and Maintenance Partnership Contract. Such equipment is not required for the provision of the Services and will belong to the Contractor. The acquisition of the office equipment by Contractor X is subject to the payment of the SUT, since the SUT exemption provided under Section

4030.08(a) of the PR Code is not applicable to these transactions, considering that such taxable items are typically acquired by entities conducting regular business operations in Puerto Rico and are not required to be acquired by Contractor X in order to fulfill its obligations under the Operation and Maintenance Partnership Contract.

(F) Applicability of Excise Taxes

Subtitle C of the PR Code provides for the imposition of excise taxes on certain products, such as fuel and motor vehicles (the “**Excise Tax**”). In general, the Government of Puerto Rico is exempt from the payment of the Excise Tax. For example, the departments, agencies, administrations, bureaus, boards, commissions, offices, public corporations, public instrumentalities and the municipalities of the Government of Puerto Rico, including the Legislative Branch and the Judicial Branch, are exempt from the payment of the Excise Tax imposed under Sections 3020.08 and 3020.09 of the PR Code on vehicles, boats and heavy equipment, as per Section 3030.16(b) of the PR Code.

Consistently with the SUT treatment referred to above, the acquisition of products otherwise subject to the Excise Tax by a Contractor that enters into an Operation and Maintenance Partnership Contract with a Partnering Government Entity will not be subject to the payment of the Excise Tax, to the extent the Contractor is required to acquire the referenced products on behalf or in the name of the Partnering Government Entity and the products are required in order for the Contractor to fulfill its obligations under the Operation and Maintenance Partnership Contract. To those effects, the Partnering Government Entity will certify to the Secretary the products that qualify as Covered Items and, accordingly, are not subject to the payment of the Excise Tax. On the other hand, the acquisition of products otherwise subject to the Excise Tax by a Contractor which are not required to be acquired under the Operation and Maintenance Partnership Contract, and which are typically acquired as part of conducting regular business operations in Puerto Rico, will be subject to the payment of the Excise Tax.

(G) Applicability of Act 48-2013

Article 1 of Act 48-2013 imposes a special contribution equivalent to one and a half (1.5) percent of the total amount of every professional service, consulting, marketing, public relationships, communications, training or orientation, and lobbying contract executed by an agency, dependency or instrumentality of the Government of Puerto Rico, public corporations, as well as by the Legislative Branch and the Judicial Branch (the “**Special Tax**”). The Special Tax must be withheld by the Puerto Rico Treasury Department or by the corresponding governmental entity at the time of making payments for services rendered under the contract. Administrative Determination No. 13-14 issued on August 28, 2013 contains a list of certain services which are subject to the payment of the Special Tax, as well as a list of other services which are not subject to the Special Tax.

As mentioned above, Article 12(a) of Act 29 provides for the imposition of a twenty (20) percent fixed income tax rate on the net income derived from the operations set forth in the Operation and Maintenance Partnership Contract, computed in accordance with the PR Code, **which applies in**

lieu of any other income tax, if any, imposed under the PR Code or any other law (emphasis ours). Accordingly, it is determined herein that a Contractor that enters into an Operation and Maintenance Partnership Contract with a Partnering Government Entity will not be subject to the Special Tax, considering that Article 12(a) of Act 29 provides that the twenty (20) percent fixed income tax rate applies in lieu of any other income tax which may be imposed under any other law.

(H) Contributions to a Government Retirement Plan

Under Article 10(g) of Act 29, certain government employees that are hired by a Contractor that enters into an Operation and Maintenance Partnership Contract with a Partnering Government Entity may continue to make contributions to the corresponding Government Retirement Plan, and the Contractor may make the corresponding employer contributions to the referenced plan. For taxable years beginning after December 31, 2018, Section 1033.15(a)(6) of the PR Code provides that the contributions made by employees to Government Retirement Plans will be considered as a reduction from wages subject to taxation in accordance with the provisions of Section 1081.01 of the PR Code.

When an employer makes contributions for the benefit of a participant in a retirement plan to an employees' trust or annuity contract which forms part of the retirement plan enjoying tax exemption according to Section 1081.01(a) of the PR Code ("**Tax Qualified Plan**"), the participant does not have to include said contributions in gross income at the time of the contribution. Similarly, contributions by a participant to a Tax Qualified Plan are made on a pre-tax basis and, accordingly, are excluded from the employee's current income.

Based on the above, it is determined herein that the contributions made by the employees to the corresponding Government Retirement Plan, which are withheld from the employees' wages, will be made on a pre-tax basis and, accordingly, will be excluded from the employees' income at the time of the contribution. Similarly, any contributions to a Government Retirement Plan made by the Contractor that enters into an Operation and Maintenance Partnership Contract with a Partnering Government Entity on behalf of such employees will not be considered at the time taxable income to the employees.

(I) Private Rulings

This Administrative Determination is intended to address certain Puerto Rico tax considerations that might be of general application to a Contractor entering into an Operation and Maintenance Partnership Contract under Act 29 or Act 120 with a Partnering Government Entity for the operation and maintenance of a Function, Service or Facility. Contractors entering into an Operation and Maintenance Partnership Contract which, due to the specific factual background, require a determination from the Secretary regarding certain tax considerations not specifically addressed in this Determination Letter should request the issuance of a private ruling from the Secretary.

In filing the ruling petition with the Secretary, the Contractor should follow the requirements established in Circular Letter of Tax Policy No. 16-09, Procedure for the Request of Private

Rulings and Issuance of Administrative Determination Letters (“**CL 16-09**”). The petition must be addressed to the Assistant Secretary for the Internal Revenue Area, and may be filed with the Puerto Rico Treasury Department (the “**Department**”) by any of the following two (2) methods:

In Person: Department of the Treasury, Ruling Request under Act 29-2009, Office 620, Intendente Ramírez Building located at 10 Paseo Covadonga, Old San Juan, Puerto Rico 00901

By Mail: Department of the Treasury, Ruling Request under Act 29-2009, Office 620, P.O. Box 9024140, San Juan, P.R. 00902-4140

Furthermore, the Contractor shall be subject to a service charge established under Article 6(a)(17)(vii) of Regulation 9115 of October 8, 2019, better known as “Regulation for the Imposition of Service Charges for Requests Submitted to the Treasury Department.” In addition, the petition must include a copy of the Operation and Maintenance Partnership Contract executed between the Contractor and the Partnering Government Entity.

The ruling petition, together with the information requested above, must be included in digital format in any external memory device. Furthermore, the Department reserves its authority to request additional information and/or documentation from the Contractor as part of the evaluation of the ruling petition.

IV. Effectiveness

The provisions of this Administrative Determination are effective immediately.

For additional information regarding the provisions of this Administrative Determination, you may contact us at (787) 622-0123, option 8.

Cordially,

Francisco Parés Alicea
Secretary of Treasury

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