

FINANCIAL OVERSIGHT & MANAGEMENT BOARD FOR PUERTO RICO



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Executive Director

BY ELECTRONIC MAIL

May 13, 2021

Mr. Omar J. Marrero Díaz, Esq.
Executive Director
Puerto Rico Fiscal Agency and
Financial Advisory Authority

Dear Mr. Marrero Díaz:

We write to you regarding Act 172-2020 (“Act 172”).

As you know, Act 172, among other things, amends Act 60-2019 (known as the “Puerto Rico Incentive Code” or “Act 60”):

- to establish a preferred tax rate of twelve percent (12%) on payments of royalties, rents, and license fees made by certain Puerto Rico export businesses to foreign entities for the use of certain intangible property (see Sections 2 and 3);
- to bring forward the time at which young entrepreneurs may begin business operations after filing for certain tax credits (see Section 4);
- to bring forward the time at which companies may sell or transfer tourism project tax credits (see Section 5); and
- to establish incentive payments to producers of extruded aluminum and aluminum recyclers (see Section 8).

On February 9, 2021, the Oversight Board received an untimely 204(a) certification for Act 172 (the “Certification”).¹ In the Certification, the Governor states in part that Sections 2 and 3 of Act

¹ As you know, PROMESA section 204(a) requires the Governor to certify whether any new law is or is not significantly inconsistent with the certified Fiscal Plan as well as to provide a formal estimate of the impact “the law will have on expenditures and revenues” within seven business days of its enactment. You requested a seven business day extension on January 22, 2021, which the Oversight Board subsequently granted. However, you still failed to submit the required documentation by the extended deadline. We remind you it is critical to the functioning of the

172 are “significantly inconsistent” with the Certified Commonwealth Fiscal Plan (the “Fiscal Plan”) but the remainder of the law does not pose any such issue. While the Oversight Board agrees with the Governor that Sections 2 and 3 of Act 172 are significantly inconsistent with the Fiscal Plan, other provisions of said Act also pose issues under PROMESA as outlined below. Accordingly, we cannot consent to the implementation of Act 172 in whole or in part since, as explained below, the Oversight Board believes Act 172 creates unavoidable violations of PROMESA Sections 204(a) and 204(c).

Noncompliance with PROMESA Section 204(a)

Sections 2 and 3 of Act 172, as acknowledged by the Governor, are significantly inconsistent with the Fiscal Plan. These sections reduce the tax rate applicable to certain payments for the use of intangible property made to foreign entities/persons by certain Puerto Rico businesses engaged in “export services” and “export trade activities.” Act 172 would establish a 12% preferential tax rate, while previously, such payments were subject to a 29% tax rate.

As stated in the Governor’s Certification, Act 172’s provision regarding the preferential tax rate for activities related to the export of goods and services will result in the reduction of revenues between \$11.6 million to \$41.3 million per year, as certified by the Puerto Rico Department of the Treasury. Nowhere in the Certification does the Governor address how the Government will offset the lost revenues. Further, as stated in the Certification the Government cannot “estimate with sufficient confidence that the economic benefit [from Act 172] outweighs its impact on revenues for the General Fund.”

In addition, even if the Oversight Board were to accept the Governor’s suggestion that Sections 2 and 3 can be separated from the rest of the measure, Act 172 would remain significantly inconsistent with the Certified Fiscal Plan. For example, Section 5 of Act 172 amends the timing under which certain Act 60 tourism tax credits can be sold or transferred such that it will inevitably impact Commonwealth revenues. As previously structured, these tax credits could not be sold or used until the relevant project was completed and the precise value of the credit determined, thus ensuring the conditions had been met and the promised benefits would accrue to the Commonwealth. Such a procedure prevented premature use of a tax credit for a project that never reached completion. Act 172’s removal of this safeguard carries unreasonable risks to Commonwealth revenues.

Further, Section 8 of Act 172 appears to provide tax incentives to aluminum plants engaged in recycling scrap aluminum and to plants that extrude aluminum regardless of source (i.e., new or recycled). However, Act 172 does not clearly define eligibility and the limits of such incentive payments. For example, in the case of a business that first produces an ingot/billet via recycled materials and then extrudes it, the language of the statute does not specify whether such a business would receive a total subsidy of 12.5 cents per pound (i.e., 6 cents for recycling plus 6.5 cents for extruding) or only one of the two.

Oversight Board and the financial health of the Commonwealth that the Government analyze these measures prior to enactment and comply fully with PROMESA Section 204 including its time limits.

The Certification states these subsidies will be funded through the Economic Incentive Fund (EIF). Subsidies to recyclers and extruders reflect entirely new incentive grants and an expansion of permissible subsidies/incentives under Act 60. However, these aluminum subsidies can be considered revenue neutral only to the extent that Economic Incentive Fund resources are fixed, such that allocating EIF resources to aluminum subsidies results in a dollar-for-dollar reduction of resources available for other incentives, all aluminum subsidies are financed solely from EIF resources, and none of the existing incentives and/or subsidies funded through the EIF are able to access alternative funding sources or are granted alternative (non EIF funded) incentives. With these assurances and with the clarifications identified above, Act 172 subsidies for aluminum production are revenue neutral and consistent with the Fiscal Plan.

Accordingly, the Oversight Board has determined Act 172 – particularly Sections 2, 3 and 5 – is significantly inconsistent with the Fiscal Plan. Further, the Governor failed to provide a complete formal estimate of Act 172’s fiscal impact by, among other things, failing to identify specific sources of funding for the provisions of Act 172. Additional assurances are also requested to confirm that the expansion of the scope of Act 60 subsidies to aluminum production will not result in a net increase in distributions from the EIF or alternative forms of funding for these or other incentives crowded out of the EIF.

Therefore, the Oversight Board notifies you pursuant to PROMESA Section 204(a)(3)(C) that Act 172 is significantly inconsistent with the Fiscal Plan and directs you pursuant to PROMESA Section 204(a)(4)(B) to “correct the law to eliminate the inconsistency” or “provide an explanation for the inconsistency that the Oversight Board finds reasonable and appropriate.” The Oversight Board further notifies you pursuant to PROMESA Section 204(a)(3) that the Government has not submitted the required formal estimate and certification and directs you pursuant to PROMESA Section 204(a)(4) to provide a formal estimate and a revised certification. The revised certification should identify the funding sources and should provide a reasonable explanation of the aforementioned inconsistencies of Act 172. Please provide all responses and requested documents on or before May 25, 2021.

Noncompliance with PROMESA Section 204(c)

For similar reasons, Act 172 represents an unlawful reprogramming in violation of PROMESA Section 204(c). There are not sufficient reserves identified in the Certification to implement Act 172. Further, spending funds in a manner not provided for in the Certified Budget constitutes a reprogramming for which prior Oversight Board approval is required pursuant to PROMESA Section 204(c). The Oversight Board has not received a request to analyze and certify a reprogramming of funds for Act 172 and has not approved such reprogramming as required under PROMESA Section 204(c). Therefore, the expenditures contemplated by Act 172 cannot be carried out and the implementation of the Act would violate PROMESA. Please confirm by May 25, 2021 that you will cease any implementation of Act 172.

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Mr. Marrero Díaz

May 13, 2021

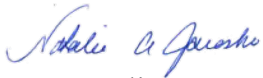
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It is clear Act 172, if fully implemented, will require additional sources of funding to offset revenue loss. The Oversight Board supports initiatives encouraging companies to expand or incorporate additional business activities, and thus increasing economic activity on the Island. However, the Oversight Board believes Act 172 to be inconsistent with the Fiscal Plan's requirements for cost-cutting and revenue neutrality.

Please comply timely with the above requests and inform us promptly should you determine not to comply. Please note, the Oversight Board reserves the right to take such actions as it deems necessary, consistent with Sections 104(k), 108(a), and 204 of PROMESA, including seeking remedies to prevent the implementation and enforcement of Act 172. We hope such action will be unnecessary.

We look forward to continuing to work together for the benefit of the people of Puerto Rico.

Sincerely,



Natalie A. Jaresko

CC: Hon. Pedro Pierluisi Urrutia
Mr. Francisco Parés Alicea
Mr. Manuel Cidre