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Secretary of State

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Approved:

Secretary of State

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Assistant Secretary of State

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PUERTO RICO TOURISM COMPANY

**REGULATION PROMULGATED TO GOVERN THE CONDITIONS FOR GRANTING
TAX EXEMPTIONS AND OTHER TAX INCENTIVES
PURSUANT TO THE PROVISIONS OF ARTICLE 9(B) OF THE
PUERTO RICO TOURISM DEVELOPMENT ACT OF 1993, AS AMENDED,
ACT NO. 78 OF SEPTEMBER 10, 1993, AS AMENDED.**

§1-1. Authority. This Regulation is promulgated by virtue of Act No. 10 of June 18, 1970, as amended, and pursuant to the provisions of Act No. 170 of August 12, 1988, as amended, and of the Puerto Rico Tourism Development Act of 1993, Act No. 78 of September 10, 1993, as amended.

§1-2. "Act"; Defined Term. Any reference to the "Act" herein shall be deemed to be to the Puerto Rico Tourism Development Act of 1993, Act No. 78 of September 10, 1993.

§1-3. Defined Terms. Any term not defined herein shall have the meaning given it in the Act.

§2(d)-1. Condohotels. Condohotel means the cluster of structures, building units, villas or group of buildings converted to the horizontal property regime, and which comply with the requirements of a Hotel; in which not less than fifteen (15) of the rooms, apartments or villas are dedicated to lodgings for travellers at all times through an integrated rental program. The individual buildings which comprise the

group of buildings, or cluster of structures need not have been submitted to the same horizontal property regime, as long as they are operated under the same integrated rental program and they comply independently with the requirements of a Hotel as defined in the following paragraph. There may be more than one integrated rental program in a structure, building, villa or cluster thereof which is a Condohotel, in which case the owner of a unit may change his program as long as he arranges for an amendment to his individual Tax Exemption Concession to reflect the change of his unit to the master Concession of another integrated rental program, and which change is reflected in said master Concession according to the provisions of Section 9(c)-1(a) of this Regulation.

The phrase "which complies with the requirements of a Hotel" means that it has all of the physical facilities, or access thereto, it provides Hotel service and complies with the Innkeepers Act. Furthermore, it must comply with the Regulation for Minimum Requirements of Hostelries and Inns of Puerto Rico promulgated by the Tourism Company or any other similar successor regulation. The owners of the individual units which are part of the integrated rental program may have use of an area to which only they have access ("owner's closet") to keep their personal belongings.

§2(d)-2. Number of Rooms or Apartments in a Condohotel. The minimum number of rooms, apartments, or villas necessary for a Condohotel to be considered an Eligible Business is fifteen

(15). For purposes of compliance herewith, there shall be considered those units which have a bathroom and private entrance.

§2(d)-3. Time Share. Time Share means the right to use a unit in a building, structure or villa for a limited period of time each year. A contribution in cash or in any other manner made for the purchase of a time share shall not be considered an Eligible Investment under the Act.

§2(d)-4. Examples. (i) A villa in a development which complies with all of the requirements of Condohotel, has three (3) rooms each with a bathroom and each with a private entrance. If the owner of the villa dedicates it to the integrated rental program, the villa shall be deemed to be contributing three (3) rooms to the requisite fifteen (15).

(ii) An apartment in a development which complies with all of the requirements of a Condohotel, has three (3) rooms each with private bathroom, but the apartment only has one entrance for all of the rooms. For purposes of compliance with the requisite fifteen (15) units, the apartment will count as one unit.

§2(d)-5. Integrated Rental Program. The phrase "through an integrated rental program" means that there is a Person who operates a business which is dedicated to renting the units of the building or group of buildings, structure or villas which are dedicated to lodging for travellers. This requirement shall not be satisfied where in a building or group of

buildings, structures or villas, the owners of the units individually dedicate them to lodgings for travellers. Such phrase includes any rental program, regardless of the manner in which the owners of the units decide to distribute the profits produced by the rental thereof. In those cases where the operator of the integrated rental program ceases to operate such program, which must be notified to the Director within fifteen (15) days of such cessation by the operator, the owners of the individual units which are part of the program shall enjoy a grace period of three (3) months, counted as of the date of termination of the program, to arrange for another integrated rental program under the same Concession, whether it be a newly created program or a program existing on the same premises, without losing the benefits of the Concession. Any income derived from the rental of the unit during the time transpired between the date of termination of the integrated rental program to which the unit was incorporated and the date of entry into the new program, as long as it occurs within said three (3) month term, shall be considered Tourism Development Income. In order for said income to be considered Tourism Development Income, however, the owner of the unit must have paid the occupancy tax required by law and the unit must have been rented for tourism purposes. Should the three (3) month period transpire without the unit having been incorporated into a new integrated rental program, the Tax Exemption Concession for said unit shall be

deemed to be terminated retroactively to the date of termination of the old integrated rental program. Said three (3) month period may be extended through prior authorization of the Director when he believes that it is in the best interests of Puerto Rican tourism.

§2(e)-1. Guest House.

Guest House means any building, part thereof, or group of buildings approved by the Puerto Rico Tourism Company to be operated for tourism purposes. It must consist of not less than seven (7) rooms for travellers, provide administrative personnel twenty-four (24) hours a day, and provide applicable hotel services according to the Innkeepers Act and the Regulation for Minimum Requirements of Hostelries and Inns of Puerto Rico promulgated, implemented and administered by the Puerto Rico Tourism Company.

§2(e)-2. Small Hostelries.

Any small hostelry which complies with the requirements of a Guest House or Tourism Villa shall be considered as such for purposes of the Act. In this manner, the Tourism Villas and small Hotels which otherwise do not comply with the Act's requirements for Hotels may enjoy the benefits of the Act, as long as they comply with the requirements for a Guest House or Tourism Villa under the Act.

§2(f)-1. New Business.

New Business means a business which is not operating at the time that an application for a Concession under the Act is

duly filed and which will be engaged in a Tourism Activity using physical facilities which have not been used, or which have been used only incidentally, in a Tourism Activity during the period of thirty-six (36) months prior to the date of filing of the application. A Condohotel shall only qualify as a New Business if the units which comprise it are acquired from the entity which developed or constructed the same, and have not been used prior to said acquisition for any purpose, in which case the purchaser shall have a grace period of four (4) months from the date of the deed of purchase and sale of the unit to incorporate the same into an integrated rental program.

The Developers of a Condohotel may also dedicate the unsold units of their Condohotel to an integrated rental program on a temporary basis without impairing the possibility that any subsequent purchasers of said units acquire the benefits of the Act, including the right to receive the tourism investment tax credit provided for in Article 5 of the Act and the corresponding sections of this Regulation. The Developers of a Condohotel who wish to take advantage of this benefit shall file an application for a Concession under the Act pursuant to the provisions of the last paragraph of Section 9(c)-1(a) hereof for purposes of obtaining solely and exclusively exemption from the payment of income taxes, property taxes, municipal licenses, and other municipal excise taxes. The Condohotel Concession shall not grant any tax

credit whatsoever to the Developer for purposes of the credits provided for in Articles 5(a) and 5(e) of the Act. The Developer may not use any unit pursuant to the provisions of this paragraph for a period exceeding ten years. The benefits of the Act which will be available to the subsequent purchaser of any unit used by the Developer under the provisions hereof shall be the same that would have been available if the unit had never been used by the Developer, except for the fact that:

(i) the tourism investment tax credit to which the subsequent purchaser will be entitled shall be the lesser amount between: (a) fifty percent (50%) of the cash contributed towards the purchase of the unit, and (b) ten percent (10%) of the lesser amount between the price at which the first comparable unit in the same Condohotel was sold immediately after commencement of the integrated rental program, and the price at which the unit was purchased by the subsequent purchaser, and

(ii) the term of ten (10) years during which the subsequent purchaser shall be entitled to the benefits granted by the Act shall be reduced by the amount of time during which the Developer used the unit.

§2(f)-2. Examples. (i) The CC Guest House, a 10 room hostelry, was in operation from January, 1985 until December, 1990. From the time it closed in 1990, the building where the Guest House was located has not been used. Mr. CC wishes to

reopen the Guest House and in February, 1994, he files an application for tax exemption under the Act. The "new" CC Guest House will qualify as a New Business under Section 2(f) of the Act. The Guest House will qualify as a New Business independently of whether it had a Tax Exemption Grant under the Tourism Incentives Act of 1983, from 1985 to 1990.

(ii) Developer ZZ developed and built "Condohotel ZZ", a complex consisting of twenty-five (25) identical villas which were dedicated to the same integrated rental program. ZZ sold twenty-three (23) of the villas for \$100,000 each and, although the villas were immediately dedicated to said program, ZZ was not able to sell the remaining two (2) villas. If ZZ wished to dedicate those last two villas to the integrated rental program on a temporary basis without impairing the possibility that the future purchaser of each villa be entitled to the tourism investment tax credit provided for in Section 2(f)-1 herein, the procedure to be followed will be: (a) ZZ will file an application for a Concession for each of the two villas requesting exemption from the payment of income, property and municipal license taxes and other municipal excise taxes only; (b) ZZ will incorporate the villas into the integrated rental program temporarily; and (c) when ZZ sells each of the two villas, the purchaser of each villa shall file an application for a Concession pursuant to the provisions of the last paragraph of Section 9(c)-1(a) of this Regulation just as if he were

obtaining a unit which had not been used prior to the date of its acquisition.

The tourism investment tax credit to which each purchaser will be entitled will be the lesser amount between fifty (50%) of the cash contributed towards the purchase of the unit and \$10,000. In order to determine the tax exemption period for the new purchasers, the period of time during which ZZ used the units on a temporary basis pursuant to the provisions of Section 2(f)-1 shall be deducted from the ten-year period to which grantees under the Act are entitled.

§2(g)-1. Existing Business. Existing Business means a business which is dedicated to a Tourism Activity at the time an application for a Concession under the Act is duly filed, or which otherwise does not qualify as a New Business under the Act, and which engages in a substantial renovation or expansion of the existing physical facilities to be used in a Tourism Activity.

§2(g)-2. Substantial Renovation or Expansion.

(a) A substantial renovation or expansion of the existing physical facilities entails an investment directed towards renovating, remodeling, or expanding the existing physical facilities, as long as the substantial renovation or expansion: (i) has an economic life of at least five (5) years and (ii) it is in real property, be it by nature or by destination. The Director shall determine the dollar amount required of each substantial renovation or expansion on a case

by case basis. In the specific case of hostelries of twenty-five (25) rooms or less, and of hostelries under the Puerto Rican Parador program sponsored by the Puerto Rico Tourism Company (independently of their size) which file an application to obtain a Tax Exemption Concession within three (3) years of the date of effectiveness of this Regulation, the Director shall take into consideration the amount of money invested during the three (3) years prior to the date of the filing of the application to determine whether the Petitioner's proposed investment project qualifies as a substantial renovation or expansion. The funds invested during the three (3) years prior to the date of the filing of the application, however, shall not be taken into consideration to compute the tourism investment tax credit to which the Exempt Business shall be entitled.

(b) In the specific case of businesses which apply for a Concession which only includes exemption from the payment of property, excise and municipal license taxes only, that is, which excludes exemption from the payment of income taxes, the term "substantial renovation or expansion" shall not include what is specified in items (i) and (ii) of the first sentence of this Section 2(g)-2. In these cases, the Director shall determine the type of investment which the business must make in order to offer a product in optimum operating conditions, and that investment shall be the one to be considered as a

substantial renovation or expansion for purposes of this section.

§2(g)-3. Examples. (i) Among the projects which are included in the definition of substantial renovation for purposes of Section 2(g)-2(a), as long as they comply with the minimum cost requirements which shall be determined by the Director on a case by case basis, are: A new wing or annex to a building, the reconstruction or remodeling of a kitchen or activities hall, or the installation of a new elevator system. On the other hand, an investment made for purchasing bed linen, television sets, or any other personal property shall not be considered to be a substantial renovation under Section 2(g)-2(a), but it could be considered to be a substantial renovation for cases under Section 2(g)-2(b).

(ii) Parador X, Inc., a fifteen (15)-room hostelry which is in an unstable financial condition, requests a Tax Exemption Concession under the Act. Since it is not able to obtain the financing necessary to make a substantial renovation or expansion for purposes of Section 2(g)-2(a) hereof, X requests that it be granted exemption from the payment of property, excise and municipal license taxes only. The Director determines that due to the good physical condition of the Parador, maintaining X in optimum operating conditions only requires an investment directed to purchasing new television sets, curtains, and bed linen for each of its rooms. The Director may approve a Concession for Parador X

which excludes exemption from the payment of income taxes, such exemption being contingent on X complying with the aforementioned conditions regarding the investment in personal property for its facilities.

§2(h)-1. Tourism Activity. Tourism Activity means:

(1) the ownership and/or administration of: Hotels, Condohotels, Puerto Rican Paradors, and Guest Houses (excluding the operation of casinos, game rooms and similar activities), theme parks, golf courses operated by or associated with a Hotel which is an Exempt Business, marinas for tourism purposes, facilities around port areas and other facilities which, due to the special attraction derived from their use as a source of active or passive entertainment, are a stimulus to internal or external tourism, as long as the Director determines that such operation is necessary and convenient for the development of tourism in Puerto Rico;

(2) the operation of a business dedicated to renting to an Exempt Business property dedicated to an activity covered by subparagraph (1) hereof, except that nothing provided herein shall apply to agreements called finance lease agreements;

(3) the development and/or administration of natural resources to be used as a source of active or passive entertainment, including, but not limited to, caves, forests, natural reserves, lakes and canyons, as long as the Director determines that such development and/or administration is

necessary and convenient for the development of tourism in Puerto Rico.

§2(h)-2. Ownership and/or Administration. It is not necessary that the ownership and/or the administration referred to in subparagraph (1) above reside within the same Person. Both activities qualify separately as a Tourism Activity regardless of whether they are undertaken by the same Person.

§2(h)-3. Golf Courses. Golf courses must be associated with or operated by a Hotel which is an Exempt Business in order to be considered as a Tourism Activity. The phrase "associated with a Hotel" means that there is a formal agreement between the golf course and the Hotel which is an Exempt Business whereby the Hotel's guests enjoy the right to use the golf course. Golf courses which are not operated by a Hotel, but are merely associated with a Hotel which is an Exempt Business, shall maintain specific records regarding the income generated by the golfers who come from the Hotel with which the course is associated. Only said income shall be considered Tourism Development Income for purposes of income tax exemption under Article 3(a)(1) of the Act and for purposes of municipal license tax exemption under Article 3(a)(3) thereof. The percentage of exemption from the payment of property taxes shall be the percentage of income generated by the golf course which is Tourism Development Income multiplied by the exemption rate from the payment of property taxes provided for by the Tax Exemption Concession.

§2(h)-4. Renting Property Dedicated to a Tourism Activity.

In order to be considered a Tourism Activity, the business which is dedicated to renting property dedicated to a Tourism Activity may not fall within the guidelines published by the Secretary in the Administrative Rulings which regulate the finance lease business. A business which is dedicated to finance leases, as set forth in said Administrative Rulings, is not considered to be dedicated to a Tourism Activity.

§2(h)-5. Theme Parks. The term "Theme park" includes any facility of a certain magnitude and with permanent structure(s) which under a specific or unifying theme provides for the recreation, leisure and enjoyment of residents and visitors. Its facilities shall be developed around a natural, historical and/or cultural resource, a scientific research subject, or a special environment, created by artificial means, which shall constitute an attraction to foreign or local tourists due to its peculiar characteristics, the singularity of the theme chosen and/or the theme's relationship with Puerto Rican culture and idiosyncrasy. For example, some themes considered within this term would be:

1. Aquatic theme - as a general rule it shall be located with direct access to the ocean, bays, lakes, lagoons, rivers or, in the alternative, the theme shall be designed and developed based on the element of water.

2. Cultural or historical theme - it shall use elements of our cultural history. Examples: theaters with plays, artisan village and IMAX theaters (with special movies on the Caribbean).
3. Natural resources theme - it shall contain attractions related to our natural resources or representative activities (forests, flora and fauna).

§2(h)-6. Tourist Marinas. Tourist Marina means a project at the edge of the water with facilities that are to be dedicated principally to the use of local or international tourism deriving the majority of its income therefrom. Its facilities and equipment shall comply with the requirements set forth by the United States Coast Guard, the Department of Natural Resources, the Public Service Commission, the Puerto Rico Ports Authority and any other regulations applicable to the operation of marinas and boats and shall include facilities for docking, fueling, the sale of food and equipment to the users. It shall also have sail or motor boats, with or without a crew, for rental to local or foreign tourists for sailing, sports fishing or other water sports, and it shall promote such services as well as services relating to the docking of visiting vessels in publications specializing in fishing, water sports, or tourism in general. The income generated by the services provided to persons who maintain their vessels at the marina permanently for their private use shall not be considered to be Tourism Development Income.

Only Tourism Development Income shall be considered for purposes of income tax exemption under Article 3(a)(1) of the Act and for purposes of the exemption from the payment of municipal license taxes under Article 3(a)(3) thereof. The percentage of exemption from the payment of property taxes shall be the percentage of income generated by the tourist marina which is Tourism Development Income multiplied by the tax exemption rate on the payment of property taxes provided by the Tax Exemption Concession.

§2(j)-1. Eligible Business. Eligible Business means any New or Existing Business dedicated to a Tourism Activity which is not covered by a tax exemption grant or resolution granted under the Industrial Incentives Act or the Tourism Incentives Act of 1983 or, if covered, such tax exemption grant or resolution is waived in favor of a Concession under the Act.

§2(j)-2. Construction Business; Operation of an Integrated Rental Program; Time Shares. The construction or development of a building or group of structures or villas which after their sale are to be used as a Condohotel shall not be considered an Eligible Business, since said business involves the construction and sale of buildings and not a Tourism Activity. The operation of an integrated rental program of units in a Condohotel is an Eligible Business, as is being the owner in fee simple of one of the individual units of a Condohotel. In the case of Time Shares, ownership of a time share shall not qualify as an Eligible Business, since the

owner of a time share is a consumer and not an Investor in the tourism industry. The operator of a time share program, however, shall be considered to be operating an Eligible Business under the Act.

§2(1)-1. Tourism Development Income. Tourism Development Income means the income of an Exempt Business resulting from the operation of a Tourism Activity, and the income resulting from the reinvestment in Puerto Rico of income of an Exempt Business obtained from a Tourism Activity, as long as such reinvestment is in a Tourism Activity.

The term "income resulting from the reinvestment in Puerto Rico of income of an Exempt Business" includes the interest generated by funds deposited in depository financial institutions in Puerto Rico, which have been reserved in the books of the Exempt Business for the improvements and/or expansions of a Tourism Activity, according to the generally accepted accounting principles (GAAP). The funds deposited for said improvements and/or expansions shall be used, in their entirety, within three (3) years of having been deposited in the aforementioned financial institutions. If they are not used within said period, the grantee shall amend its income tax returns and shall pay taxes on the interest derived for that part of the funds deposited which was not used for improvements and/or expansions within the three (3) year period. Likewise, the term "income resulting from the reinvestment in Puerto Rico of income of an Exempt Business"

shall also include the interest generated by funds deposited in depository financial institutions in Puerto Rico originating from accounts which the Exempt Business is required to maintain by the financial institution(s) which provided the financing for the Tourism Project as a condition for providing said financing. The proportion of such interest which shall be considered to be "income resulting from the reinvestment in Puerto Rico of income of an Exempt Business" shall be that proportion of the interest attributable to the Tourism Activity and not to other activities of the Exempt Business such as, for example, a casino. The Department of the Treasury of the Commonwealth of Puerto Rico shall determine the procedure to be followed to report the origin of the exempt interest.

If the Exempt Business is a Hotel, Condohotel, Parador or Guest House, the income subject to exemption shall include income from: (1) room rent and charges for services related to the Tourism Activity, (2) the sale of food and beverages, (3) the operation of retail stores within the physical facilities of the Exempt Business, but only if such retail stores are owned and operated by the Exempt Business, (4) the operation of golf courses and other sports and recreation facilities which are part of the Tourism Activity of the Exempt Business, (5) the leasing of commercial space within the Hotel, Condohotel, Parador or Guest House for the operation of businesses which provide useful services to the traveling guest.

In the specific case of the units which are part of the integrated rental program of a Condohotel, the operator of such program shall certify annually to the Department of the Treasury and to each unit owner the amount of Tourism Development Income generated by the unit. The owners of units in Condohotels shall attach a copy of said certification to their income tax returns for each year in which they report Tourism Development Income.

§2(1)-2. Examples. In general terms, any income received by the Exempt Business from a Tourism Activity shall be considered Tourism Development Income. For example, if the Exempt Business is a Hotel, Condohotel, Guest House or Puerto Rican Parador, the income derived from the rental of meeting and banquet space, concert halls, the rental of sports equipment, sports lessons, tours, the sale of food and beverages, game rooms for minors, stores operated by the Exempt Business within its physical facilities for retail sales, and the leasing of commercial space within its physical facilities for the operation of businesses which provide services to traveling guests shall be considered Tourism Development Income. On the other hand, income derived from activities which are not covered by the Tax Exemption Concession, such as, for example, the operation of a casino, shall not be considered Tourism Development Income in any case. The list above is not exhaustive but rather illustrative.

§2(l)-3. Reinvestment of Tourism Development Income. The income generated by an Exempt Business from reinvesting income derived from Tourism Development Income in a Tourism Activity in Puerto Rico, equal to or different from that of the Exempt Business, shall produce additional Tourism Development Income.

§2(m)-1. Investor. Investor shall mean anyone who makes an Eligible Investment. When the Person who makes the Eligible Investment is a Fund, the Participants shall be considered to be Investors and not the Fund.

§2(m)-2. Examples of Those Who Shall Not Be Considered Investors. The following Persons shall not be considered to be Investors: (i) those contributing money in exchange for stock or an interest in a business which constructs or develops a building or group of buildings which will be sold to Persons who will dedicate the units in the building to a Condohotel's integrated rental program, since the one who constructs or develops is in the business of constructing and selling buildings, which is not considered to be a Tourism Activity; (ii) the Developer of a Tourism Project who acquires participations in a Tourism Investment Capital Fund which will make an Eligible Investment in that same Tourism Project.

§2(n)-1. Eligible Investment. Eligible Investment means:

(1) the amount of cash which has been contributed to an Exempt Business to be used in a Tourism Activity in exchange for (i) corporate stock, if the Exempt Business is a corporation; (ii) an interest, or the increase in an interest in a

partnership or joint venture, if the Exempt Business is a partnership or joint venture; or (iii) a unit in a Condohotel, as long as the Investor is the owner of the unit and the unit is dedicated to the integrated rental program of the Condohotel for a period of ten (10) years, and is available to be used by said program for eleven (11) months of each calendar year. The operator of the Condohotel shall certify annually the number of days during which each unit was used by its owner. Failure to comply with this requirement may result in the imposition of the penalty provided in Section 8(b)(3)-1 hereof. The thirty (30) days of each year during which each Investor in a Condohotel shall have the unit at its disposal shall be determined by the operator according to the needs of the business and they need not be used consecutively.

The owners of the units of a Condohotel shall also have at their disposal up to sixty (60) days per year during which, should the volume of business of the Condohotel so permit it, they may use their units as "walk-ins." In order to benefit from this privilege, the owners of the units shall communicate with the operator of the Condohotel after eleven o'clock in the morning (11:00 a.m.) of the day on which they wish to use the unit to corroborate that the same has not been previously reserved for that day. The operator of the Condohotel shall charge a reduced daily rate, for purposes of covering the maintenance expenses, to the owners of the units who use the same under the provisions of this paragraph.