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August 8, 2012

CIRCULAR LETTER OF THE PUERTO RICO MOTION PICTURE ARTS, SCIENCES AND INDUSTRY DEVELOPMENT CORPORATION NO. 12-04

TO: PERSONS ENGAGED IN A FILM PROJECT APPLYING FOR THE BENEFITS UNDER ACT NO. 27 OF MARCH 4, 2011, AS AMENDED, KNOWN AS THE "PUERTO FILM INDUSTRY ECONOMIC INCENTIVES ACT".

SUBJECT: PUERTO RICO PRODUCTION EXPENSES INCURRED IN RELATION TO OUTSIDE VENDOR ACQUISITIONS.

Pursuant to Article 2.2(l)(4)(b) of Act No. 27-211 of March 4, 2011, as amended, the Puerto Rico Film Industry Economic Incentives Act (the "Act"), the Secretary of the Department of Economic Development and Commerce (the "Secretary of Development") may approve as valid Puerto Rico Production Expenses¹ the cost incurred by a Grantee in acquiring or leasing goods from a Puerto Rico Resident when the latter acquired said goods from a vendor located outside of Puerto Rico by reason or in anticipation of the order placed or to be placed by the Grantee (the "Outside Vendor Acquisitions"). The purpose of this letter is to announce the acceptable parameters for respecting Outside Vendor Acquisitions by Puerto Rico Resident suppliers that would yield valid Puerto Rico Production Expenses for Grantees.

Article 3.5 of the Act provides that the Secretary of Development may delegate to the Executive Director of the Puerto Rico Motion Picture Arts, Sciences and Industry Development Corporation (the "Film Commissioner") any of the powers granted to him by the Act, except for matters related to designation of the geographic areas as Film Development Zones pursuant to the provisions of Articles 6.1 and 8.4 of the Act. On March 4, 2011, Administrative Order No. OA-01-2011 and Circular Letter No. 11-01 of the Department of Economic Development and Commerce were signed by the Secretary delegating to the Film Commissioner all the powers granted to him under the Act, including the power to approve or deny applications, transfers and/or amendments to Decrees and the power to authorize the concession of tax credits under the Act (the "Administrative Determinations").

¹ All terms not defined herein will have the meaning given to them in the Act.

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Ordinarily the purchase or lease of goods by a Grantee from a Puerto Rico Resident in connection with the development, pre-production, production and postproduction of a Film Project that complies with Article 4.1 of the Act constitutes a Puerto Rico Production Expense. Article 2.2(l)(4) expressly excludes from the definition of Puerto Rico Production Expenses, Outside Vendor Acquisitions performed through a Puerto Rico Resident when considering all facts and circumstances the transaction lacks economic substance. This prohibition seeks to avoid the use of Puerto Residents as mere conduits for purposes of generating Puerto Rico Production Expenses that will form part of the basis for granting income tax credits under the Act without the creation of sound economic activity in Puerto Rico.

Grantees acquiring or leasing goods from Puerto Rico Residents, that in turn participate in Outside Vendor Acquisitions, who wish to consider said expenses as Puerto Rico Production Expenses in their application for income tax credits must be able to demonstrate the following:

1. The acquisition or lease is from a Puerto Rico Resident as defined in the Puerto Rico Internal Revenue Code of 2011, as amended. In the case of acquisitions from juridical persons, for purposes of the Puerto Rico Production Expense requirement, an entity organized in Puerto Rico or outside of Puerto Rico with a fixed place of business in Puerto Rico (owned or rented) and one or more employees working physically in Puerto Rico will be considered a Puerto Rico Resident;
2. The Outside Vendor Acquisition performed by a Puerto Rico Resident supplier is as a result of lack of availability of the goods in the Puerto Rico market, or if available in Puerto Rico, said goods can be furnished by the Puerto Rico Resident performing the Outside Vendor Acquisition at a 10% or greater discount than the price being offered by another Puerto Rico resident supplier which has the good in inventory; and
3. The Puerto Rico Resident supplier derives a profit from the Outside Vendor Acquisition considered reasonable under the industry standards.

The above test can be illustrated by means of the following example:

Company P has entered into a one year lease for office space at a location in Puerto Rico. The leased office is staffed by one full time employee with a one year employment contract. From the leased office space location, the employee issues purchase orders for \$7,000 to out of Puerto Rico suppliers of major

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equipment that were available in Puerto Rico at a cost of \$10,000. Company P resells to a Grantee the equipment acquired at \$8,750.

Company P is considered a Puerto Rico Resident, since it has a location in Puerto Rico with an employee originating purchase orders. The amount paid by the Grantee for the equipment is considered a valid Puerto Rico Production Expense because the equipment was acquired by the Grantee at a 10% or greater discount than the price being offered by another Puerto Rico resident supplier and the Puerto Rico Resident supplier derived a reasonable profit from the sale.

Expenses for goods furnished by Puerto Rico Resident suppliers to Grantees that form part of Outside Vendor Acquisitions complying with the terms of this letter will be considered valid Puerto Rico Production Expenses. However, any part of the mark-up charged by the Puerto Rico Resident supplier (i.e., excess above: (i) the cost of the good charged by the non-Puerto Rico vendor to the Puerto Rico Resident supplier, (ii) reasonable allowance for shipping costs and (iii) insurance, if applicable) deemed unreasonable, based on industry standards for comparable goods acquired at retail, will not be considered a valid Puerto Rico Production Expense.

The Film Commissioner adopts this Circular Letter based on the authority granted by the Administrative Determinations.

The provisions of this Circular Letter will be effective immediately.

Attentively,



Mariella Pérez Serrano
Film Commissioner