



Circular Letter No. 2016-001

August 4, 2016

**TO THE GRANTEES, APPLICANTS, REPRESENTATIVES OF GRANTEES AND
APPLICANTS OF TAX EXEMPTION UNDER THE PROVISIONS OF ACT 20-2012,
AS AMENDED**

RE: Series LLC's treatment for purposes of Act No. 20-2012, as amended

I. STATEMENT OF MOTIVES

Act No. 20 of 2012, as amended, known as the "Act to Promote the Export of Services" (the "Act" or "Act 20") was enacted in order to foster an export service industry and provide the necessary elements to diversify Puerto Rico's economy into a knowledge-driven services economy. The Act offers a 4% income tax rate and several tax exemptions to any entity with an office or "bona fide" establishment located in Puerto Rico which carries out eligible services that are, in turn, considered services for export.

The Department of Economic Development and Commerce ("DEDC") and the Office of Industrial Tax Exemption ("OITE") have received numerous consultations regarding the treatment, for Act 20 purposes, of "series limited liability companies" ("Series LLC"). The consultations received revolve around matters such as the rules for inclusion of series of a limited liability company in an Act 20 application or decree; the minimum employment requirement; and the supplementary documentation needed to evaluate an Act 20 application presenting such corporate structure.

The purpose of this Circular Letter is to address the above-mentioned questions as well as provide a better understanding of this special form of limited liability company in connection with the provisions of the Act.

II. LEGAL BASIS

This Circular Letter is promulgated pursuant to Article 3 of Reorganization Plan No. 4 of June 22, 1994, as amended, which provides that the DEDC is responsible for implementing and supervising the execution of Puerto Rico's public policy on economic development in the various entrepreneurial sectors of manufacture, commerce, tourism, film, services, cooperatives among others. Also, articles 10(b)(i) and 11(a) of Act 20, which provide that the Secretary of the DEDC ("Secretary") may establish special procedures for Act 20 tax exemption decrees through regulations, circular letters, or any administrative pronouncement. Once the special procedures are established, the

Secretary shall have discretion to include those terms and conditions in Act 20 tax exemption decrees that are consistent with the purposes of the Act and that promote the socioeconomic development of Puerto Rico, respectively.

Furthermore, pursuant to Article 10 (b) (ii) (G) of Act 20 and Administrative Order No. OA-03-2012 of August 13, 2012, the Secretary authorized the Executive Director of the Office of Industrial Tax Exemption to carry on administrative duties of all nature, related with grants of tax exemption issued under the provisions of Act 20.

In light of the public policy adopted by the Secretary pursuant to Act 20, the Office of Industrial Tax Exemption hereby notifies the rules that will govern the procedures relating to the requests made by applicants or grantees, regarding operations under Act 20 that involve limited liability companies with separate classes of members, managers or interests ("Series LLC").

III. DEFINITIONS

For purposes of this Circular Letter, the following terms shall have the meaning and scope stated below. Terms used in the singular form shall also include the plural form, and vice versa.

A. "Certificate of Formation" – Means the certificate through which a limited liability company is formed.

B. "Decree" – Means a decree approved by the Secretary of the Department of Economic Development and Commerce, pursuant to the provisions of the Act, and which is in effect in accordance with the rules and conditions that the Secretary may establish.

C. "Limited Liability Company" or "LLC" – Means any regular limited liability company created under the laws of Puerto Rico, or under the laws of any state of the United States or any other foreign country or jurisdiction.

D. "Limited Liability Company Agreement" or "LLC Agreement" – Means the written agreement (whether referred to as a limited liability company agreement, operating agreement, or otherwise) duly adopted by the members of a limited liability company to govern the internal affairs and administration of a limited liability company.

E. "Manager" – Means a person who is appointed manager of a limited liability company or designated as manager of a limited liability company under a limited liability company agreement or other similar document under which the limited liability company is formed.

F. "Member" – Means any natural person, partnership (whether general or limited), trust, estate, association, corporation, limited liability company or any other individual or entity, whether domestic or foreign, admitted as member to a limited liability company.

G. "Series" – Means any separate classes (also known as "series") of members, managers or interests of a limited liability company established according to Article 19.17(B) of the General Corporations Act of Puerto Rico, Act No. 164 of December 16, 2009, as amended.

I. "Series Limited Liability Company" or "Series LLC" – Means a special form of limited liability company with a particular structure that allows for the creation of multiple separate classes (also known as "series") of members, managers or interests under a limited liability company.

J. "Ultimate Owners" – Means those natural persons (whether members or managers) who exercise ultimate effective control or administration over a Series LLC or any of its Series.

IV. DISCUSSION

A. Series LLCs

Series LLCs are a unique form of limited liability companies in which the articles of formation specifically allow for unlimited segregation of membership interests, assets and operations into independent Series. The creation of Series provides for the creation of independent rights, powers or liabilities, thus providing liability protection to the Series LLC as well as among the multiple Series.

According to Article 19.17(A) of the General Corporations Act of Puerto Rico, Act No. 164 of December 16, 2009, as amended ("Corporations Act"), an LLC Agreement "may establish or provide for the establishment of Series of members, managers or LLC interests which shall have separate rights, powers or duties with respect to specified properties or obligations of the LLC or profits or losses associated with specified properties or obligations and, to the extent provided in the LLC Agreement, any such Series may have a separate business purpose or investment objective."

Nevertheless, in order to enjoy such benefits, Series LLCs must comply with the requirements set forth in Article 19.17(B) of the Corporations Act, namely: (i) the LLC Agreement must provide for the establishment of one or more Series; (ii) separate and distinct records for each Series must be maintained; (iii) the assets relating to each Series must be maintained separate from the assets of the LLC or any other Series, and (iv) a general notice of the limitation on liabilities of the Series must be set forth in the Certificate of Formation, whether or not the LLC has established any Series when such notice is included in the Certificate of Formation.

B. Act to Promote the Export of Services

Article 10(b)(i) of the Act provides that any person who has established or plans to establish an eligible business in Puerto Rico may request the benefits of the Act by filing a duly sworn application at the Office of Industrial Tax Exemption ("OITE"). Pursuant to Article 10(b)(ii)(G) of the Act, and Administrative Order No. OA-03-2012 of August 13, 2012, the OITE is the agency in charge of carrying on administrative duties of all nature, related with grants of tax exemption issued under the provisions of the Act, with the

exception of approving or denying tax exemption grants and carrying on any other duty specifically bestowed upon the Secretary by the Act.

As part of those administrative duties and pursuant to the authority conferred, the OITE is authorized to require Act 20 tax exemption decree applicants to submit the necessary sworn statements to establish the stated, required, or pertinent facts, in order to determine whether such applicant's service operations, or proposed service operations, qualify under the provisions of the Act. It is also authorized to require applicants to submit all evidence that may justify the requested tax exemption.

In accordance to the abovementioned authority, on December 23, 2015, the OITE issued Circular Letter No. OEI 2015-003 in which, in light of Act No. 187 of November 17, 2015, also known as the "Act of the Interagency Validation Portal for the Issuance of Puerto Rico Economic Development Incentives", conveys the new legal mandate regarding employee commitment for Act 20 cases:

With the purpose of adopting the new mandate of requiring five (5) employees per Act 20 application, it is hereby determined that applications filed after November 30, 2015 with one applicant will be subject to a five (5) direct job requirement on and after two (2) years from commencement of operations and for the remaining exempted period, in the activities covered by the Grant. Within said period of two (2) years, those cases will be subject to the three (3) job requirement on and after six (6) months from commencement of operations. The adoption of this period allows both local and foreign companies a reasonable time to comply with the provisions of Act 187 [of November 17, 2015], while increasing the effectiveness of Act 20 as an economic development and job creation tool. The inclusion of co-grantees to all Act 20 Grants (those filed prior to and after December 1, 2015) will be subject to a general rule of employment commitment of three (3) employees per new co-grantee, subject to the rules adopted by the DEDC and the OITE.

For purposes of a tax exemption grant issued under Act 20-2012, the term "co-grantee" includes separate legal entities (including corporations and limited liability companies) and series.

On the other hand, Article 10(d)(i) of the Act establishes that the transfer of a decree, or of the shares or any other property interest in an eligible business that holds a decree granted under the Act, requires the prior consent of the Secretary. Although the before mentioned provision contemplates certain exceptions (see, Article 10(d)(ii) and (iii) of the Act, in which only a notification to the Secretary, the Executive Director of the Puerto Rico Industrial Company, the Executive Director of the OITE and the Secretary of the Department of Treasury is required), the transfer of stocks or any partner's shares when said transfer does, directly or indirectly, result in a change of ownership or control of an eligible business that holds a decree granted under the Act requires the Secretary's prior consent.

V. DETERMINATIONS

Based on our analysis of Series LLCs as to their application to Act 20, it is hereby determined that said legal structure provides a useful tool to attract more investment

and business to Puerto Rico. Nevertheless, given that the Series of a Series LLC can have rights, powers or duties, profits and losses, and a business purpose or investment objective separate from the Series LLC and other Series, the following determinations are made with the purpose of providing clear guidelines regarding the treatment for Act 20 applicant or grantees organized as Series LLCs.

A. Employment Requirement

It is hereby determined that the Series LLC shall be treated as the Applicant or Grantee for Act 20 purposes, while the Series of a Series LLC shall be treated as Co-Applicants or Co-Grantees. Therefore, pursuant to Circular Letter No. OEI 2015-003:

1) Any Series LLC that filed an Act 20 application after November 30, 2015 shall be subject to a five (5) direct job requirement to be complied on and after two (2) years from the commencement of operations and for the remaining exempted period in the activities covered by the Grant. Within said period of two (2) years, the Series LLC (Applicant) will be subject to the three (3) job requirement on and after six (6) months from commencement of operations.

2) The inclusion of any Series (Co-Applicants or Co-Grantees) of a Series LLC to all Act 20 applications or tax exemption decrees (those filed prior to and after December 1, 2015) will be subject to a general rule of employment commitment of three (3) employees per new Series; unless it is demonstrated to the satisfaction of the Secretary, with clear and convincing evidence, that such general rule shall not be applied to the particular case. Considerations such as reasonableness of the employment commitment per new Series, in light of Grantee's actual employment; type of eligible service; and purpose of the new Series, among others, shall be taken into account.

B. Ultimate Ownership

In all cases having a Series LLC structure, each Series, as well as the LLC (also known as the Master LLC), shall have a 20% common ultimate ownership. As a result thereof, tax exemption cases under Act 20 involving a Series LLC will require that all the Series have common ultimate ownership as established in this Circular Letter. In all cases regarding the "common ultimate ownership" rule, OITE will look through the ultimate individuals having a membership ownership in the Series.

C. Change of Control

Any change to the Series LLC Agreement or its Series organizational structure affecting the ultimate ownership or ultimate owners of either the Series LLC or any of its Series, must be previously authorized by the Secretary, pursuant to Article 10(d)(i).

Furthermore, and in accordance with Article 10(d)(ii) and (iii) of the Act, if such changes in ownership do not represent a majority of the control or administration of the LLC or Series, then it must only be notified to the Secretary, as well as to the Executive Director of the Puerto Rico Industrial Company, the Executive Director of the OITE, and the Secretary of the Department of the Treasury.

Consequently, both the Series LLC and its Series must comply with the provisions of Article 10(d) of the Act, as applicable.

D. Supplementary Documentation

In order to handle and evaluate Act 20 cases presenting a Series LLC organizational structure, it is hereby determined that any Series LLC applying for an Act 20 tax exemption decree must submit to the OITE, along with its application, and in addition to any other supplementary documentation or information, the following:

- 1) Copy of the Certificate of Formation issued by the Department of State of the Commonwealth of Puerto Rico, which shall contain a notice of the limitation on liabilities of the Series;
- 2) Copy of the executed Series LLC Agreement and its amendments, which govern the internal affairs and administration of the Series LLC and its Series and sets forth the members and their respective participations in the equity of each of the Series LLC and its Series;
- 3) Copy of any separate executed operating agreement regarding the Series;
- 4) Copy of any executed agreement regarding the management of both the Series LLC and its Series;
- 5) Organizational Chart of the Series LLC;
- 6) A detailed description of the activities to be performed by the Series LLC and each of its Series;
- 7) The business purpose and/or investment objective of the Series LLC and its separate Series, including if the Series were created to support the LLC in the rendering of Act 20 services as a single operational unit or if, instead, were created to actively undertake Act 20 services; and
- 8) Any other pertinent document requested by the OITE.

The OITE will not evaluate a case involving Series LLCs when all the documents requested herein have not been furnished to the OITE. It is important to note that any change to said information or documents must be notified, unless otherwise indicated, by submitting a sworn statement to the OITE, within thirty (30) days of the change, along with any attachment deemed necessary. Copy of the aforementioned documents must also be submitted to OITE in cases of amendments to Act 20 tax exemption decrees that are related to any change to the corporate structure or ownership of a Series LLC grantee.

VI. EFFECTIVENESS

The provisions of this Circular Letter shall take prospective effect immediately after its approval.

For more information regarding the provisions of this Circular Letter, please contact the Office of Industrial Tax Exemption at (787)764-6363.



Elizabeth Aponte Rivera
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Office of Industrial Tax Exemption