



Municipalities Implement Initiatives to Increase Revenue Collection

By: Felipe Mariani Franco

Earlier this year, the Oversight Board, appointed under the “Puerto Rico Oversight, Management and Economic Stability Act (“PROMESA”), approved the fiscal plan of the central government of Puerto Rico which proposes a reduction of \$350 million to the transfers received by the municipalities. At the same time, due to the financial crisis of the central government, the municipalities have been assuming some of the responsibilities and services that the central government used to offer.

This reduction in the funds to be transferred by the central government to the Municipalities, together with the effect of a long-lasting recession, is expected to have a severe financial effect in the budget of all the municipalities. Trying to mitigate the effect of this shortage of funds, certain municipalities have implemented initiatives that impose fees, charges or taxes to its residents, be individuals or businesses. As with most initiatives with a negative economic impact, these initiatives have not been well received by the residents of those municipalities nor by their business community.

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Authority to Impose Taxes by the Municipalities

Act 81-1991, as amended, known as the "Autonomous Municipalities Act of the Commonwealth of Puerto Rico of 1991", provides, among other things, economic autonomy to municipalities. However, such autonomy must be subordinated and exercised in accordance with the Constitution of the Commonwealth of Puerto Rico and such act. It provides broad authority to the municipalities to impose taxes, fees, licenses, and tariffs in the activities performed within the territorial limits of each municipality. However, it limits that authority to matters in where there is no preemption by the central government (i.e., the central government has not legislated an imposition of a tax, fee, license or tariff to that transaction, income or property).

The limitation in the authority to impose taxes by a municipality is best reflected in Compañía de Turismo de Puerto Rico v. Municipio de Vieques, 179 DPR 578 (2010), a case involving the preemption imposed by Act 81-1991. In this case, the Puerto Rico Supreme Court decided that a room tax imposed by the Municipality of Vieques was contrary to Act 81-1991 because it imposed the tax on the same event that the room tax imposed by the Commonwealth. Basically, the Puerto Rico Supreme Court decided that the Municipality may not impose a tax on a transaction already subject to a Commonwealth tax.

Initiatives by the Municipalities

As previously mentioned, the municipalities in Puerto Rico are in dire need of funds to be able to pay for the management of the municipality and provide services to its residents. In their budgetary analysis, they identified waste management as the service with the highest cost of all the services they provide. Therefore, some of the municipalities have established ordinances imposing charges to individuals and businesses based on the waste generated by them.

Municipalities trying to impose a charge on waste collection services are having implementation and collection issues.

They need to determine on which basis to charge, how to make the charge and, more importantly, how to collect (and what happens to those that do not want to pay). Some municipalities are considering contracting government run utilities (power or water) to provide the billing services. Another one is requiring the exclusive waste bag which will be taxed upon its purchase.

Although all these initiatives will have collection and implementation issues, the constant in all of them is that they are within the authorization provided by Act 81-1991 to impose taxes. However, two other municipalities, the Municipality of San Lorenzo and the Municipality of Caguas, have approved ordinances which may put to test the preemption limitation in Act 81-1991.

Municipality of San Lorenzo

On March 17, 2017, the Mayor of the Municipality of San Lorenzo signed the Municipal Ordinance No. 16-OT Series 2016-2017. This ordinance authorizes the Mayor to establish and collect an excise tax from businesses, merchants, professionals and any other dedicated to a for profit activity within the Municipality to be used in embellishment, ornamental and recycling projects. The excise tax will be half of the municipal license tax declared by those businesses in their volume of business declarations for the calendar year 2015 or for the current year, whichever is higher. Taxpayers holding a tax exemption decree, will benefit from the tax exemption granted in the determination of this excise tax.

We are aware that this excise tax has not been well received by the Municipality's business community. Furthermore, some taxpayers have decided not to pay the tax and await the collection efforts from the Municipality to decide if and how to contest its validity.

Municipality of Caguas

On June 13, 2017, the Mayor of the Municipality of Caguas signed Municipal Ordinance No. 28 for fiscal year 2016-2017 establishing a Municipal

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Felipe has extensive experience in corporate tax advisory for the retail, distribution and manufacturing industries. Among his areas of expertise, Felipe works with corporate tax incentives, corporate reorganizations, closing agreements with governmental entities, consumption tax issues and tax accounting work. As per his involvement with government, Felipe has participated in special projects related to the drafting of tax related laws, ordinances and regulations for the Commonwealth of Puerto Rico, Municipalities and private entities.

He is frequently invited as speaker at many tax seminars sponsored by the Puerto Rico Society of Certified Public Accountants and other professional associations and private organizations.

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Business Contribution (“MBC”) to be mostly used (60%) in improvements, cleaning and maintenance of green areas, streets, roads or infrastructure, as well as in recreation and sports facilities, schools and environmental conservation efforts. Subsequently, on June 23, 2017, Ordinance No. 28 was substituted by Ordinance No. 37 for fiscal year 2016-2017. On July 13, 2017, Ordinance 37 was amended by Ordinance No. 2 for the fiscal year 2017-2018.

Ordinance 37, as amended (the “Ordinance”), provides for a MBC of 0.35% of the volume of business declared or that should have been declared by the taxpayer to the Municipality of Caguas in the Volume of Business Declaration for the year prior to the effectiveness of the Ordinance (year 2016). The volume of business used to determine the MBC will never be higher than the volume of business generated during the calendar year 2016. However, that maximum volume of business will be reduced by the increases in the volume of business generated in future years. Therefore, future sales increases will not be subject to the MBC and will reduce the basis on which the MBC is determined.

The MBC is applicable to every person that is subject to the municipal license tax in the Municipality of Caguas and had declared or should have declared a volume of business of \$3,000,000 or more during the calendar year prior to the effective date of the MBC. For those taxpayers with a tax exemption decree, issued by the central government or the Municipality, the MBC will be determined as established by such grants. Educational institutions will be fully exempt from the MBC.

The Ordinance establishes that the MBC will be effective only for two years, fiscal years 2017-2018 and 2018-2019 (Ordinance No. 28 and 37 provided a four-year effective period, it was reduced to two years by Ordinance No.2). Starting in 2017 and on or before the 1st of July of each year, the Municipality of Caguas will bill the MBC to each taxpayer. The payment will be due the 15th day of the month of August.

However, it may be paid in four equal installments on the 15th day of August, November, February and May.

This Ordinance is facing fierce opposition by the taxpayers affected by it. We know of at least three court cases filed by several companies and a couple of trade associations. The plaintiffs on those cases claim that this Ordinance is unconstitutional and illegal because (1) it imposes a tax on the same basis as that imposed by the Municipal License Tax Act but in excess of what the Municipal License Tax Act authorizes the municipalities to impose, (2) its language is so vague that there is uncertainty on how to determine the base on which the tax will be imposed and (3) it will result in an illegal double taxation. Furthermore, some plaintiffs are informing the Puerto Rico court that they reserve the right to file a case in Federal court arguing that the imposition of the MBC will result in a reduction in income tax collections which may affect the Commonwealth budget approved under PROMESA.

Other Municipal Initiatives

During the year various municipalities have issued Ordinances to increase real and property tax rates. Among the municipalities that increased their real and personal property tax rate are the Municipalities of Carolina, Cidra, Aibonito, Loiza, Sabana Grande and Barranquitas. These Ordinances are well within the authority conferred to them by law.

House Bill 971

Besides the initiatives by the municipalities mentioned above and others which may follow, the House of Representatives is considering an amendment to the Municipal License Tax Act of 1974, as amended, which will increase the maximum tax rate that the municipalities may charge for Municipal License Taxes.

House Bill 971 was filed on April 27, 2017 by the Speaker of the House of Representatives, Carlos Méndez Núñez, and another representative from the same political party. This bill proposes to increase the maximum rate that may be imposed by a Municipality on financial businesses from 1.5% to 1.9% and to all other businesses from 0.5% to 0.9%.

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This bill still is in its early stages of the legislative process and has not had any activity since May 10, 2017. However, due to the impact it may have on businesses in Puerto Rico it is important to follow it.

ATBA Comments:

The impact of the financial crisis to the municipalities has made them consider new ways of increasing their revenues. As mentioned in this bulletin, some municipalities have taken the lead and have established

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initiatives of their own. If they prevail over the challenges, we can expect other municipalities to follow.

We will continue to follow upon these initiatives and keep you informed. If you have questions regarding any of the municipal ordinances discussed above, please contact one of our tax advisors. Our tax advisors can provide you with more information regarding these ordinances, determine the impact to your business and assist you in adjusting your current forecasts.

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