



GOVERNMENT OF PUERTO RICO

Puerto Rico Sales Tax Financing Corporation

Tuesday, October 29, 2019

Update to Puerto Rico Treasury Sales and Use Tax Collections and Distributions reporting

The Puerto Rico Sales Tax Financing Corporation ("COFINA") is issuing this press release to comment on the Puerto Rico Treasury Department's ("PR Treasury") implementation of a new sales and use tax ("SUT") collections and distributions reporting system. On October 28, 2019, PR Treasury published its Distribution of Monthly Collection Report with respect to SUT collections and distributions for the fiscal quarter ended September 30, 2019 (the "New Report"), including restated July 2019 collections to conform to the new reporting method. Consistent with changes implemented as part of the restructuring of COFINA's bonds pursuant to Act 241-2018 and COFINA's Third Amended Title III Plan of Adjustment, dated January 9, 2019, approved by the U.S. District Court for the District of Puerto Rico pursuant to Title III of the Puerto Rico Oversight, Management and Economic Stability Act, the New Report incorporates changes to how the PR Treasury reports SUT collections and distributions. The New Report presents SUT collections in the manner provided for under the COFINA Plan of Adjustment and Confirmation Order, clearly delineates the amounts that each party owns and is entitled to receive and does not alter any substantive ownership rights set forth in the COFINA Plan of Adjustment and Confirmation Order.

On February 12, 2019, COFINA, PR Treasury, The Bank of New York Mellon, Government Development Bank for Puerto Rico and Banco Popular de Puerto Rico ("BPPR") entered into an Instruction Agreement Regarding Certain Sales and Use Tax Revenues of the Puerto Rico Sales Tax Financing Corporation (the "Instruction Agreement"). The Instruction Agreement, among other things, required the preparation and delivery of a SUT collection report setting forth the allocation of SUT collections between COFINA and the Commonwealth of Puerto Rico (the "Commonwealth"). Effective on June 30, 2019, COFINA, PR Treasury and BPPR entered into an Amended and Restated Banking Services Agreement ("BSA") that, among other things, incorporated the collection reports required by the Instruction Agreement.

SUT is paid through PR Treasury's electronic tax filing system (referred to as "SURI") and developed using a platform employed by various other states, including California, Connecticut, Georgia, Illinois and Massachusetts) and directly deposited into an SUT clearing and aggregation account (the "SUT Collections Account") at BPPR. The SUT Collections Account is jointly owned by COFINA and the



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Commonwealth. SUT collections received in the SUT Collections Account include (i) the SUT imposed at a rate of 6%, comprised of (a) 5.5% (the "Base SUT"), which first collections and distributions of which, up to a certain specified amount for each fiscal year, is owned by and allocated to COFINA and made subject to a statutory lien in favor of COFINA's bondholders, and the excess of which is owned by and allocated to the Commonwealth and (b) 0.5% (the "FAM SUT") that is allocated to the Municipal Administration Fund (the "FAM"), (ii) the SUT surcharge imposed at a rate of 4.5% (the "SUT Surcharge"), which is owned by and allocated to the Commonwealth, (iii) a special SUT imposed at a rate of 4.0% applicable to designated professional services, certain business-to-business services and imported services (the "Special SUT"), which is owned by and allocated to the Commonwealth, (iv) certain municipal SUT which is owned by and allocated to the Municipal Finance Corporation ("Municipal SUT"), and (v) other SUT related collections such as fines, penalties and interest imposed on delinquent SUT taxpayers ("SUT Fines and Penalties"), which are owned by and allocated to the Commonwealth. Large taxpayers are required to make SUT payments twice a month through SURI and to file a tax return on the 20th of each month with respect to SUT payments made on the preceding month or, in the case of use and import returns, on the 10th day of each month. All other taxpayers are required to make monthly SUT payments through SURI and to file a tax return on the 20th of each month, with respect to SUT payments made on the preceding month

Prior Method of Reporting SUT Collections and Distributions

Prior to the implementation of the BSA, all amounts deposited in the SUT Collections Account were distributed between COFINA and the Commonwealth using a proportional distribution method, regardless of the ownership interest in the collected SUT funds. This historical method of distribution was used because PR Treasury lacked an electronic tax filing platform (such as SURI) to allow for the precise allocation and distribution of the component SUT collections. Distributions pursuant to this method were based on the proportion that the 5.5% SUT first distributed to COFINA bore to the total rate of SUT of 10.5%, until COFINA received its annual base amount. Because of the proportional distribution method, COFINA received its annual corresponding share of the Base SUT in an accelerated manner, since COFINA was receiving a share of collections of certain component SUT funds that should have been distributed to the Commonwealth or municipalities.

Pursuant to the above-described distribution method of amounts deposited in the SUT Collections Account, PR Treasury's historical monthly SUT collection report showed the total amounts deposited in the SUT Collections Account and provided an estimated break-down of amounts allocated to COFINA, the Commonwealth's General



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Fund, the FAM and the Municipal Finance Corporation based on the application of the proportional distribution method.

New Method of Reporting SUT Collections and Distributions

The New Report shows in separate line items, the monthly amounts that correspond to the Base SUT, the FAM SUT, the SUT Surcharge, the Special SUT, the Municipal SUT and the SUT Fines and Penalties. Upon the implementation of the BSA, all amounts deposited in the SUT Collections Account are now being specifically allocated to COFINA and the Commonwealth according to their respective ownership interests based on amounts reported by taxpayers in their tax returns, which segregate the portion that corresponds to the Base SUT and the other SUT categories. The New Report now reflects the new distribution method as implemented in the BSA. Thus, there are no longer any distributions to COFINA of SUT collections that correspond to Commonwealth-owned funds. This provides a precise allocation of SUT collections between COFINA and the Commonwealth and improves compliance with accounting standards regarding the timing of the recognition and recording of revenues.

The new distribution method results in lower monthly distributions of SUT collections to COFINA, when compared to the historical proportional distribution method, for the following reasons: first, as stated above, COFINA now receives only amounts that it owns that correspond to the Base SUT and no longer receives any funds related to other SUT collections that belong to the Commonwealth or the municipalities; and, second, unlike prior fiscal years when all amounts deposited in the SUT Collections Account were distributed based on the proportional method explained above, amounts can now be distributed to COFINA only once the proper allocation of the amounts that correspond to the Base SUT has been made based on taxpayers' tax returns, which results in timing-differences of distributions to COFINA.

The New Report and the Unallocated SUT Collections

The New Report also shows a line item labeled as "Unallocated SUT Collections," which reflects amounts on deposit in the SUT Collections Account at month-end for which the corresponding tax returns have not yet been filed. These "Unallocated SUT Collections" amounts include (i) payments corresponding to large taxpayers' obligation to make SUT payments twice a month that are deposited in the SUT Collections Account but cannot be allocated and distributed until the corresponding tax return is filed on the 20th day of the following month identifying the amounts that correspond to the Base SUT, the FAM SUT, the SUT Surcharge, the Special SUT and the SUT Fines and Penalties (the "Bi-monthly Payments"), (ii) overpayments, which are payments made by certain taxpayers in excess of their SUT obligation and where the



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taxpayer has not yet applied the resulting credit (the “Overpayments”), and (iii) payments made by taxpayers where the taxpayer has failed to file the tax return showing how the payment should be allocated. In the case of the Overpayments, these mostly result from certain large taxpayers that make SUT bi-monthly payments based on estimates that are in excess of their actual SUT obligation, in order to avoid the imposition of penalties by PR Treasury.

The following examples illustrate some of the previously described situations:

1. Taxpayer A, who is a large retailer, is required to make Bi-monthly Payments. For August 2019, Taxpayer A would have made the required Bi-monthly Payments through SURI and PR Treasury would have received the amounts paid in the SUT Collections Account. Taxpayer A will allocate the Bi-monthly Payments made during August 2019 in the tax return it will file on September 20, 2019. As a result, when PR Treasury reports August 2019 SUT collections early in September 2019, Taxpayer A’s Bi-monthly Payments for August 2019 will appear as Unallocated SUT Collections because it has yet to file the tax return.
2. Taxpayer A makes Bi-monthly Payments during August 2019 based on sales estimates. Because Taxpayer A is aware of the penalties associated with failure to comply with its Bi-monthly Payment obligation, it uses conservative estimates to determine the amounts to be paid. When Taxpayer A files the tax return in September 20, 2019, it may recognize that it overpaid because final sales for August 2019 were less than estimated. This overpayment is included as an Unallocated SUT Collection because it does not belong to COFINA or the Commonwealth. Also, to the extent that Taxpayer A does not use this overpayment as a credit to its next payment obligation, the overpayment amount will continue to grow in the SUT Collections Account and will remain as Unallocated SUT Collections because it does not belong to either COFINA or the Commonwealth.

In summary, the New Report provides increased precision in the allocation of SUT collections to COFINA and the Commonwealth and ensures that each party only receives the SUT collections it is entitled to receive. This increased precision results in a reduction of amounts transferred to COFINA as compared to prior years because (i) COFINA will no longer receive amounts owned by the Commonwealth as was the case under the proportional distribution method and (ii) certain amounts will remain unallocated in the SUT Collections Account until the corresponding tax return is filed. As noted above, however, the New Report does not alter any of COFINA’s substantive



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ownership rights in SUT collection, as set forth in the COFINA Plan of Adjustment and Confirmation Order.

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