



April 1, 2016

**CIRCULAR LETTER OF THE DEPARTMENT OF ECONOMIC DEVELOPMENT  
AND COMMERCE NUMBER 16-01**

**TO: FILM PROJECT APPLICANTS OF BENEFITS GRANTED UNDER THE  
PUERTO RICO FILM INDUSTRY ECONOMIC INCENTIVES ACT.**

**RE: FILM PROJECT APPLICATION PROTOCOLS AND VALIDATION OF  
PUERTO RICO PRODUCTION EXPENSES**

**I. INTRODUCTION**

Pursuant to Act No. 27-2011 of March 4, 2011, as amended, the Puerto Rico Film Industry Economic Incentives Act ("Act 27"), the Secretary of the Department of Economic Development and Commerce ("Secretary of Development"<sup>1</sup>) is authorized to provide Grants to persons engaged in a Film Project, an Infrastructure Project and to Studio Operators and Large Scale Studio Operators, which provide numerous tax incentives and tax credits. Article 3.5 of Act 27 provides that the Secretary of Development may delegate to the Director of the Puerto Rico Film Commission (the "Film Commission") any of the powers granted to him by Act 27, 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 Act 27.

Article 3.2(a) of Act 27 provides that the Secretary of Development shall establish through regulations or circular letters the documents, information and requirements to be provided and followed by a Person interested in availing the benefits of Act 27. Article 3.2(b) of Act 27 also establishes the criteria that should be considered to evaluate a Grant application. Article 3.2(b)(6) of Act 27 further specifies that such criteria shall include any other factor to be established by the Secretary of Development through regulation or circular letter consistent with promoting the best interests of Puerto Rico and/or the purposes of Act 27. In addition, Article 3.4(b) of Act 27, grants the Secretary of Development authority to establish the requirements and procedures to be followed by the Auditor. Pursuant to the Administrative Determinations and Articles 3.2(a), 3.2(b), 3.2(b)(6) and 3.4(b) mentioned above, the Secretary of Development hereby sets forth the procedures to be followed in connection with all Film Project


<sup>1</sup> All terms not defined herein shall have the same meanings given to them in Act 27.

applications and the validation of Puerto Rico Productions Expenses. This Circular Letter shall replace the provisions set forth in Circular Letter 12-08. Failure to comply with the procedures established herein, including applicable filing dates and deadlines, may result in denial of, forfeiture or modification of the benefits granted under Act 27.

## **II. LEGAL BASIS**

This Circular Letter is hereby issued in accordance with the authority granted to the Secretary under Act 27.

## **III. DEFINITIONS**

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- A. Act – Means the Puerto Rico Film Industry Economic Incentives Act. Number 27 of March 2011 as amended.
  - B. Art Director – Crew member responsible for designing and preparing all the decoration and construction of studio or outdoor settings as required by the script. Task that requires knowledge of architecture and design which will determine the mood, atmosphere and visual quality of a film.
  - C. Assistant Director - Known as the Director's right hand who takes action on the logistic part of the filming process. It's the person that relieves the Director of many routine responsibilities. Such routine work includes keeping the schedule on time, maintaining order and discipline on the set, and making sure actors and crew members are in the right place at the right time.
  - D. Auditor – an independent Certified Public Accountant authorized to practice said profession in Puerto Rico, contracted by the Grantee to carry out the functions contemplated under this Act.
  - E. Bond – an irrevocable standby letter of credit issued by a financial institution duly authorized to do business in Puerto Rico, the assurance of a surety, insurance or bonding company or a guarantee issued by a creditworthy person, in each case acceptable to the Secretary of the Treasury, to the effect that a Film Project or Infrastructure Project shall be completed within the corresponding proposed term and parameters. In the case of Film Projects, "Bond" shall include a "Completion Bond".
  - F. Budget- The expenses to take into consideration when producing a film. Calculation of the money to be spent for the everyday shooting to make sure production stays within the parameters of the allotted money.

- G. Code – means Act 1-2011, as amended, known as the “Puerto Rico Internal Revenue Code of 2011”, or any subsequent similar Law that replaces it.
- H. Composer - The individual who creates the original music for a Film Project.
- I. Conflict of Interest – Any situation in which a direct or indirect benefit of the person or his/her relatives, in accordance with the Government Ethics Law of Puerto Rico of 2011, is or may be reasonably expected to clash with the interests of the Film Commission or the public interest in relation to one or more projects to be evaluated.
- J. Director of Photography/cinematographer – Crew member responsible for the lighting of the set or location. This person's duties are, but not limited to, the composition of the frame, color of the images, setting and movement of the camera.
- K. Director - The individual that orchestrates a vast number of aspects of a filming process in order to deliver the final look of a motion picture. The director has to control the creative part of film, both interpretive and technical. He has to dictate the action in front of the camera while guiding the acting, sound, lighting, camera movement, and the dialogue which results in transforming the screenplay into a film.
- L. Editor - The individual responsible for constructing the various audio and visual components of an audiovisual project into a coherent piece.
- M. Executive Producer - The person in charge or responsible for a film's production (development, pre-production, production and post-production) yet rarely takes part in any filmmaking phase. He often has a more business wise outlook on the productions he manages.
- N. Film Commissioner – the Director of the Department of Development and Commerce Film Program.
- O. Film Development Zones – the geographic areas designated pursuant to Article 6.1 of this Act.
- P. Film Project – defined according to the provisions of Article 4.1 (b) of this Act.
- Q. Promotional Still – A single photograph or picture taken during production of a film project for the purpose of exhibiting the image as marketing material.
- R. Fund or Cinematographic Fund – Means the Fund of the Department of Development and Commerce Film Program, created pursuant to Act 171-2014, as amended.



- S. Government— Means the political structure of the Commonwealth of Puerto Rico, including all of its municipalities, instrumentalities, subdivisions, agencies, and public and quasi-public corporations.
- T. Governor – Means the head of State for the Commonwealth of Puerto Rico.
- U. Grant – the concession of authority pursuant to the Act, by the Secretary of Development of Economic Development and Commerce to allow a person engaged in film projects or infrastructure projects, or studio operator, or large-scale studio operator to avail him/herself of the incentives set forth in the Act, subject to compliance with the requirements of the Act. "Grant" shall have the same meaning as "incentives grant", "tax exemption", "tax incentives" or merely "incentives," "exemption", "grant", or "license", which can be used indiscriminately, as may be convenient for the purpose of illustrating what is provided in the corresponding text.
- V. Grantee – a Person that has received a Grant under the provisions of this Act.
- W. Infrastructure Project – the development or substantial expansion in Puerto Rico of studios, large-scale studios, laboratories, facilities for postproduction, animation and special effects, facilities for the international transmission of television images or other media, or other permanent facilities to carry out Film Projects (regardless of whether said projects avail themselves of the provisions of this Act), whose hard costs budget, as certified by the Auditor, exceeds one million dollars (\$1,000,000).
- X. Insert – A shot that intercuts within a scene to help explain the action, emphasize a point, or facilitate continuity. Nevertheless, is not part of the principle photography of a film project.
- Y. Large Scale Studio Operator – person dedicated to administer and operate a Large Scale Studio.
- Z. Large-Scale Studio – a comprehensive purpose-built, high-capacity film and television production studio, developed and operated within a Film Development Zone, suitable for the purposes of housing sound stages and exterior sets, including facilities for set construction and design, production offices, and production services departments catering to the production community and such other built-in necessary amenities or facilities, as determined by the Secretary of Development of Economic Development and Commerce, through regulation, circular letter or administrative determination, with a budget equal to or greater than one hundred million dollars (\$100,000,000), as certified by the Auditor.
- AA. Legislative Assembly – Means the House of Representatives and the Senate of the Commonwealth of Puerto Rico, acting jointly.

- BB. Location— Any place away from the studio where a film is set for shooting.
- CC. Principal Photography – the phase of production during which a film project is shot. It exclusively comprises the filming of scenes or elements that tell the story. Consequently, inserts or shots of sorts that does not move the narration forward are not consider as part of the principal photography.
- DD. Producer – The private entrepreneur who is the holder of intellectual property rights of the work and is responsible for the making and marketing of the film project.
- EE. Production Expenditures – development, preproduction, production and postproduction expenditures directly incurred in the production of a Film Project. Expenditures related to the development of a Film Project shall only be included when not less than fifty percent (50%) of the Principal Photography of the Film Project takes place in Puerto Rico. Expenditures related to the preproduction, production and postproduction shall not be required to comply with the aforementioned fifty percent (50%) of Principal Photography requirement to be considered Production Expenditures.
- FF. Puerto Rico Production Expenditures – payments made to Puerto Rico Residents, and/or Qualified Nonresidents for services physically rendered in Puerto Rico, that are directly attributable to the development, preproduction, production and postproduction of a Film Project. Expenditures related to the development of a Film Project shall only be included when not less than fifty percent (50%) of the Principal Photography takes place in Puerto Rico. Expenditures related to the preproduction, production and postproduction shall not be required to comply with the aforementioned fifty percent (50%) of Principal Photography requirement to be considered Puerto Rico Production Expenditures. In order to constitute Puerto Rico Production Expenditures, the payments received by the Puerto Rico Residents and Qualified Nonresident shall be subject to income taxes in Puerto Rico as provided in this Act, whether directly or through a professional services corporation, cooperative, or other legal entity. Puerto Rico Production Expenditures include payments related to the development, preproduction, production and postproduction of Film Project, including, but not limited to, the following:

- (1) Wages, fringe benefits, per diems or fees for talent, management or labor to a person who is a Puerto Rico Resident or a Qualified Nonresident. Nevertheless, per diems of a person that is not a Puerto Rico Resident a

Qualified Nonresident, could be, up to the discretion of the Secretary of Economic Development, included in the definition of Puerto Rico Production Expenditures;

(2) interests, charges and fees paid to persons listed in Section 1033.17(f)(4) of the Code; and/or

(3) any of the following goods or services provided by a supplier that is a Puerto Rico Resident;

(A) the story and screenplay to be used for a Film Project;

(B) set construction and operations, wardrobe, accessories and related services;

(C) photography, sound synchronization, lighting and related services;

(D) editing and related services;

(E) rental of facilities and equipment;

(F) leasing of vehicles, including the chartering of aircraft or watercraft provided such aircraft or watercraft is registered and home ported in Puerto Rico and such leasing is limited for travel within Puerto Rico, its airspace and territorial waters;

(G) food and lodging;

(H) airfare if purchased through a Puerto Rico-based travel agency or travel company for travel to and from Puerto Rico or within Puerto Rico that is directly attributable to the Film Project;

(I) insurance coverage and bonding; provided, that it is purchased through an insurance producer authorized to do business in Puerto Rico; and

(J) other costs directly attributable to the Film Project in accordance with generally accepted entertainment industry practice, as determined by the Secretary of Development through regulations, circular letter or administrative determination.

(4) The following shall be excluded from the Puerto Rico Production Expenditures definition:

(A) Those items paid to Puerto Rico Residents with the money in cash obtained through any subsidy, gift, sponsorship or fund appropriation from the Government of the Commonwealth of Puerto Rico.

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Those items paid to Puerto Rico Residents with monies in cash obtained through contributions made to a Film Project through advertising sponsorships, brand or product integration, or media buys, or, that by their nature and terms are refundable, such as loans or investments, including contributions by the Puerto Rico Motion Picture Fund created under the Motion Picture Corporation Act may, at the discretion of the Secretary of Development, be included in the definition of Puerto Rico Production Expenditures.

(B) The costs of goods acquired or leased by Puerto Rico Resident suppliers outside of Puerto Rico for resale to a Grantee, that do not comply with the rules issued by the Secretary of Development by regulation and/or circular letter and when, in the judgment of the Auditor, there is no economic substance in the transaction; and

(C) Those items paid to Puerto Rico Resident entities mainly for the services rendered by natural persons not considered Puerto Rico Residents, except for entities rendering Qualified Nonresident services.

GG. Puerto Rican Actors and Actresses – Talent that acts on camera that is considered; a Puerto Rico Resident, within the meaning of the *Puerto Rico Internal Revenue Code of 2011*, a non-resident individual born in Puerto Rico or a non-resident individual, descendant of a Puerto Rican father or mother up to second degree of consanguinity *including* (grandchildren).

HH. Puerto Rico Resident – an individual who meets the requirements set forth in Section 1010.01(a) (30) of the Code and/or a corporation, partnership, limited liability company, cooperative or other legal entity organized under the laws of the Government of the Commonwealth of Puerto Rico, or engaged in trade or business in Puerto Rico pursuant to the provisions of the Code, which must derive not less than eighty percent (80%) of its gross income from sources within Puerto Rico, using the rules prescribed in Section 1032.04 of the Code, related to the sources of income.

II. Qualified Nonresident – Producer, director, writer, onscreen talent (except a helper, also known as an extra), including stuntmen, known as "Above the Line", and any person of technical or creative nature behind the lens, known as "Below the Line", and any other

similar person who in accordance with the general practice accepted in the entertainment industry is considered "Above the Line" or "Below the Line", as determined by the Secretary of Development, that is not considered a Resident of Puerto Rico.

JJ. Rough Cut – One of the first versions of a film that has not undergone the proper editing, yet it follows the storyline. It's an assembly of various scenes which will undergo further editing under the supervision of the director and other personnel.

KK. Scene – An action sequence within the film that normally unifies within a single location and time.

LL. Screenwriter – Natural person that creates the original script, the dialogues or the adaptation from another source, on which the cinematographic project is based.

MM. Screen Credit – The artwork provided by the Film Commission that should be placed in a prominent position within the credit roll of the finished Film Project

NN. Script/Screenplay – Text that includes dialogue, action, stage directions, setting, sound, and various degrees of shooting instructions for any of the stages of the screenplay for a motion picture. The written text upon which a film production is based.

OO. Secretary of Development – the Secretary of Development of Economic Development and Commerce of the Government of the Commonwealth of Puerto Rico.

PP. Secretary of the Treasury – the Secretary of the Department of the Treasury of the Government of the Commonwealth of Puerto Rico.

QQ. Special Effects Supervisor - Someone who is in charge of the special effects department team. Such activities may include props, makeup effects, scenery, pyrotechnics, wind, rain, clouds, etc.

RR. Studio – a comprehensive purpose-built, high-capacity film and television

SS. Studio Operator – the Person dedicated to administer and operate a Studio.

TT. Supporting Actor - Thespian that plays a fairly important role but not the lead part.

UU. Transfer – means, as appropriate in each case, a lease, sale, exchange, transfer, assignment or conveyance in any manner of real or personal property, as the case may be.

VV. Viral Media- Refers to a digital video, image, or article that has spiked in popularity and has reached a large number of users in a short period of time. While there is no exact number of views



that makes something "go viral," most viral media is viewed by more than a million people in less than a week.

#### IV. ELEGIBILITY

A. A Person may obtain a Grant with respect to a Film Project, subject to numerous circumstances. A Film Project means:


1. Feature length fiction films;
2. Short fiction films;
3. Feature length documentaries;
4. Short documentaries;
5. Series in episodes, miniseries and television programs of a similar nature, including pilots;
6. Music videos;
7. National and international commercials, including campaigns composed of various commercials as long as the campaign commercials are aggregated in a single contract or purchase order with aggregate Puerto Rico Production Expenses of at least \$50,000.00, that individually complies with the requirements established in Act 27, as amended;
8. Video games;
9. Recorded live performances;
10. Original soundtrack and dubbing recordings for any of the above;
11. Television programs, including but not limited to reality shows, talk-shows, news programs, game-shows as well as entertainment, comedy children's and variety programming; or
12. The postproduction of one or various Film Projects mentioned above, as long as all Film Projects are aggregated in a single contract or purchase order with aggregate Puerto Rico Production Expenses of at least \$50,000 that individually complies with the remaining requirements established in Act 27.



B. A Film Project does not include any of the following:

1. a production that includes pornographic material;
2. a production that primarily consists of religious or political advertising;
3. a radio program;
4. a production that primarily markets a product or service other than a national or international commercial;
5. a production with the primary purpose of fund-raising;
6. a production that primarily is for employee training or in-house corporate advertising or other similar production; or
7. any other project as determined by the Film Commission through circular letter.

C. Some of the conditions for eligibility are:

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1. The production and/or post-production of the Film Project must be carried out in whole or in part in Puerto Rico;
  2. In the case of a Film Project other than (1), (2) and (3) mentioned above under Part (A.), it must be intended for airing, commercial distribution or exhibition to the general public outside of Puerto Rico by any means and media. Such airing, distribution or exhibition outside of Puerto Rico may not be considered incidental or minimal;
  3. Puerto Rico Production Expenses must be at least \$50,000, except in the case of Film Projects mentioned in paragraph (2) and (3) above under Part (A.), for which Puerto Rico Production Expenses must be at least \$25,000, or one or various Film Projects mentioned in paragraph (6) and (11) above under Part (A.), which may aggregate Puerto Rico Production Expenses to a total of at least \$50,000.
  4. Except for the Film Projects mentioned in paragraph (6), (7) and (11) above under Part (A.), Film Projects must include a screen credit in connection with Puerto Rico's production incentive program. (Please refer to Circular Letter Number 15-xxx).

- D. The Film Commission will request as part of the application process any documents that are deemed necessary to assure the previous conditions are met. Such documentation will include, but not be limited to, all information requested in Form PRFPG-1. In the case of national and international commercials, evidence of actual airing, commercial distribution or exhibition to the general public outside of Puerto Rico may be requested. Eligible Film Projects distributed by "viral media" will be evaluated on a case by case basis.

## V. APPLICATION PROCESS

- A. The Film Commission will issue to eligible parties interested in receiving the income tax benefits and tax credits (the "Applicants") granted under Act 27 a Welcome Letter where project nature will be identified and an Agreement Letter. Said Agreement Letter stipulates clearance for high ranking government officials to visit the set. The Applicant shall submit the Agreement Letter within 10 days of issuance;
- B. Applicants interested in receiving income tax benefits under Act 27 in connection with a Film Project must complete and file an application with the Film Commission using Form PRFPG-1. In order to be eligible for consideration such application must be filed before the end of Principal Photography. In the case of standalone post-production, videogames or soundtrack and dubbing recording, such application must be filed before the end of post-production or production, respectively. (Form PRFPG-1 is available at [www.filminpuertorico.com](http://www.filminpuertorico.com));
- C. The Film Commission shall review the application and if needed, request any additional documents or information necessary for evaluating the application. Once the application is deemed completed with the required documents established in Act 27 and its circular letters, the Film Commission will notify the Secretary of Development of the Film Project's intentions to apply for the Film Incentives Tax Credit;
- D. After a thorough review, applications will be submitted to the Puerto Rico Treasury Department for general review and certification of tax credits availability;
- E. The Puerto Rico Treasury Department may request additional documents or information necessary for evaluating the application;

- F. The Puerto Rico Treasury Department shall review applications within a 15 working day period. This term will be interrupted if additional information is requested by the Agency. Whenever the 15 working day period is so interrupted and the information requested is furnished by the Applicant, the Puerto Rico Treasury Department shall only have the remaining days of the 15 working day period to complete its review;
- G. After the Puerto Rico Treasury Department review and recommends or endorses the project, the Department of Economic Development and Commerce will decide if a Letter of Intent will follow;
- H. If tax credits were reserved by the Puerto Rico Treasury Department the Film Commission will inform the Applicant of said allocation. In addition the Film Project will be endorsed through a Letter of Intent only if it meets Act 27 and its circular letter requisites;
- I. Applicant will be required to pay a filing fee totaling 1% of the budgeted expenses that qualify for the tax credits, up to a maximum amount of \$250,000 (the "Filing Fee"). Fifty percent (50%) of such fees, based on an estimate of the Puerto Rico Production Expenses filed with the application, will be required to be paid at the time of the issuance of the Letter of Intent. The remaining balance will be payable upon completion of the Film Project and certification of the qualifying expenditures, as described below;
- J. The Applicant must hire an independent certified public accountant licensed in Puerto Rico (the "Auditor") to complete an agreed upon procedures audit, as described in Section VI below (the "Audit Report"), to validate the amount of Puerto Rico Production Expenses. The name and information of the Auditor must be submitted to the Film Commission for evaluation and approval. The Film Commission may consider previous performance of the Auditor with respect to other Film Projects and type of compensation arrangement as part of the evaluation of the Auditor. Such approval will be provided in the notification described in paragraph (K.) below;
- K. After an application finalizes the Puerto Rico Treasury Department review process, described in paragraph (H.) above, the Film Commission will notify the Applicant, request the payment of 50% of the Filing Fee specified in paragraph (I.) above. The actual amount of tax credits to be approved will be confirmed upon completion of the Film Project pursuant to the certification of the Puerto Rico Production Expenses by the Auditor through the Audit Report, subject to the


payment of the remaining balance of the Filing Fees and full balance of the Nonresident Below the Line Fee (as defined below);

- L. Once the Letter of Intent is issued the Applicant will have a 30-day period, which may be extended by the Film Commission for reasonable cause, to start Principal Photography (or post-production or production, in the case of standalone post-production and videogames or soundtrack and dubbing recordings) to be considered in compliance. Failure to start principal photography, production or post-production as required will be deemed as non-compliance of the Letter of Intent with respect to the tax credits and tax credits reserved may be forfeited, as well as the Filing Fees paid. The Applicant may re-submit the application with respect to the tax credits and request that the Filing Fees paid be credited with respect to the new application of tax credits. The new application of tax credits will be subject to tax credit availability at the date of its filing;
- M. Once the Film Project is completed and the Applicant furnishes the Auditor the necessary information for the Audit Report, the Auditor shall have a term of 30 days to complete the Audit Report, which may be extended by the Film Commission for 30 additional days for reasonable cause. Failure to submit the Audit Report on the required date will be deemed as non-compliance of the Grant with respect to the tax credits and tax credits reserved may be forfeited, as well as the Filing Fees paid. The Applicant may re-submit the application with respect to the tax credits and request that the Filing Fees paid be credited with respect to the new application of tax credits. The new application of tax credits will be subject to tax credit availability at the date of its filing;
- N. The Audit Report will be submitted to the Film Commission and the Puerto Rico Secretary of the Treasury for their review and certification of tax credit availability based on the Agreed- Upon Procedures Report;
- O. Within 30 days of receipt of the Audit Report by the Puerto Rico Secretary of the Treasury, the Puerto Rico Secretary of the Treasury must certify the tax credit to the Film Commission. This 30-day period may be interrupted if the Puerto Rico Secretary of the Treasury requests additional information to the Auditor. Whenever the 30-day period is so interrupted and the information requested is furnished by the Applicant or the Auditor, the Puerto Rico Secretary of the Treasury shall only have the remaining days of the 30-day period to complete the certification process; and

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- P. Once the tax credit certification described above is received, the Film Commission will notify the Secretary of Development of tax credit availability. The Grant and certification will be signed by the Secretary of Development. Afterwards, the Film Commission will confirm to the Applicant that the tax credit is available for use or transfer and will provide the Grant and certification signed by the Secretary of Development, subject to the payment of the remaining balance of the Filing Fees. At such time, the Applicant shall also be required to pay an additional fee totaling 1% of the Puerto Rico Production Expenses corresponding to payments made to Qualified Nonresidents designated as "Below the Line" as set forth in the Audit Report (the "Nonresident Below the Line Fee"). In order for the tax credits to be available, the Applicant will have a period of 15 working days from the date of the confirmation to pay the remaining balance of the Filing Fees and the entire balance of the Nonresident Below the Line Fee. Failure to pay the remaining balance of the Filing Fees and the entire balance of the Nonresident Below the Line Fee will be deemed as non-compliance of the Notice of Intention with respect to the tax credits and tax credits reserved may be forfeited, as well as the Filing Fees paid. The Applicant may re-submit the application with respect to the tax credits and request that the Filing Fees paid be credited with respect to the new application of tax credits. The new application of tax credits will be subject to tax credit availability at the date of its filing. The terms and conditions of Transfer of tax credits shall be governed by Internal Revenue Circular 11-03.

## VI. TAX CREDIT ADVANCE

 Tax credits issued under Act 27 may be advanced in the following situations:

- A. Upon receipt of a Letter of Intent, Applicant may advance 50% of the tax credit reserved under the Applicant by placing a Bond acceptable to the Puerto Rico Secretary of the Treasury, which names the Puerto Rico Secretary of the Treasury as beneficiary, for the face value of 50% of the tax credits. The Bond shall remain in place until the Puerto Rico Secretary of the Treasury certifies the tax credit to the Film Commission pursuant to Part IV, Paragraph (O.) above. The Puerto Rico Secretary of the Treasury shall issue to the Applicant a letter (with copy to the Secretary of Development and Film Commission) certifying that the bond is acceptable and the amount of the advance credits available for sale and use;

- B. If no bond is placed as described in Section V (A) above, Applicant may still advance 50% of the tax credit authorized under the Grant, if the Auditor certifies to the Puerto Rico Secretary of the Treasury that 50% or more of the budgeted Puerto Rico Production Expenses has been disbursed, following the Agreed Upon Procedures guidelines described in Part VI below, and upon receipt of a letter from the Puerto Rico Treasury Department that (with copy to the Secretary of Development and Film Commission) certifies the amount of the advance credits available for sale and use.


The remaining balance of the tax credits that were not advanced will be subject to the procedure described in Section IV (M),(N),(O), and (P) above. Tax credits generated by payments made to Qualified Nonresidents shall not be eligible for the tax credit advance in this Section V.

#### **VI. AGREED-UPON PROCEDURES**

- A. Once the Film Project is completed, an Agreed Upon Procedures Audit must be completed by the Auditor following the guidelines provided in Section IV.
- B. The Auditor must be a Certified Public Accountant licensed to practice in the Commonwealth of Puerto Rico, who is not related to the Applicant and /or producer of the Film Project and under no other type of contract or arrangement with the Applicant and /or producer of the Film Project.
- C. The Audit Report of the Puerto Rico Production Expenses must be conducted in accordance with Statements on Standard for Attestation Engagements applicable to Agreed-Upon Procedures and the Auditor must have sufficient knowledge of accounting principles and practices generally recognized in the film and television industry.
- D. The Auditor must prepare and present as part of the Audit Report: (i) a schedule of eligible costs incurred by calendar year, and (ii) provide notes to the report, including the notes described below. The schedule of eligible costs must set forth a breakdown with the full name of the payees by the proper budgetary item, as set forth in paragraph (G.)(ii) below, or describing the concept of the payment if such cost does not correspond to any of the items set forth in paragraph (G.)(ii) below.
- E. Puerto Rico Production Expenses will count towards the Tax Credits subject to: (i) in the case of production and post-production expenses, those incurred from the day stated on the Application to the Tax Incentive

Program, and (ii) in the case of development and pre-production expenses, those that can be validated as being related to the Film Project covered by the Grant.

- F. The Audit Report must be addressed to the Applicant. The Auditor's name, address, and telephone number must be evident on the report. The Audit Report must be dated as at the completion of the audit fieldwork. The Film Project title must be disclosed. The period during which the costs were incurred must be disclosed.
- G. The following procedures set forth minimum standards for acceptability of the Agreed-Upon Procedures to be performed. The Auditor is to make the certification considering the following guidelines and on the basis of having performed, at a minimum, these procedures:

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- i) The Auditor must verify all costs, expenses and disbursements incurred to determine that: (i) it has been duly invoiced to the Applicant or its designee, (ii) has been paid by the Applicant or its designee, (iii) it is related to the production costs, and (iv) it is considered an eligible cost. The process should include examination of invoices, source documents, and contracts and cancelled checks. Also, the Auditor shall verify that: (1) all deposits associated to the 20% withholding on payments to Qualified Nonresidents have been performed by comparing the deposit coupon of tax withheld at source Form 480.31 (field labeled as "other") and informative returns 480.6C<sup>2</sup> with the Qualified Nonresident expense claimed by the Applicant, and (2) that all Puerto Rico Production Expenses claimed correspond to the economic reality of the transactions, that the benefit to Puerto Rico is more than a mere pass-thru activity and that it represents a true purchase and sale by a Puerto Rico vendor. The Film Commission may allow certain pass-thru transactions, subject to the provisions of Circular Letter No. 12-04, or any successor administrative determinations.
- ii) These costs must be charged to the proper budgetary item. Costs covered by making a lump-sum payment must be broken down by category; amount and vendor (if principal vendor contracts with other vendors for purposes of providing the


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<sup>2</sup> In the event that the informative returns on form 480.6C are not available for the taxable year under review, the Auditor may perform the analysis set forth in paragraph (G.) (i) (I) by comparing the deposit coupon of tax withheld at source Form 480.31 against a copy of the payment instrument made to the corresponding Qualified Nonresident.

article or service, all vendors in the supply chain must be identified). Production costs that will qualify for the production tax credit shall not exceed standard market rates. Examples of production costs that will qualify for the production tax credit include, but are not limited to the following:

1. wages, fringe benefits, per diems or fees for talent, management or labor to a Person who is a Puerto Rico Resident or a Qualified Nonresident. The treatment of per diems shall be subject to the provisions of Circular Letter No. 12-11;
2. interest, charges and fees paid to financial institutions doing business in Puerto Rico; and/or
3. any of the following provided by a vendor that is a Puerto Rico Resident:
  - a. the story and script to be used for a Film Project;
  - b. set construction and operations, wardrobe, accessories and related services;
  - c. photography, sound synchronization, lighting and related services;
  - d. editing and related services;
  - e. rental of facilities and equipment with a brief explanation of use and purposes;
  - f. leasing of vehicles, including the chartering of aircraft or watercraft provided such aircraft or watercraft are registered and home ported in Puerto Rico and such leasing is limited for travel within Puerto Rico, its airspace and territorial waters;
  - g. food or lodging (i.e. solely expense for room night);
  - h. commercial airfare if purchased through a Puerto Rico-based travel agency or travel company for travel to and from Puerto Rico or within Puerto Rico that is directly attributable to the Film Project;
  - i. insurance coverage and bonding if purchased through a Puerto Rico-based insurance agent or broker; and
  - j. production fees or similar budgetary items but only up to 10% of the Puerto Rico Production Expenses.



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- iii) For expenditures that are considered eligible only in part, the Auditor must verify the allocation of cost formula to assure that its appropriately reflecting the expenditure related to the Puerto Rico production.
  - iv) The cost report must be in U.S. dollars. Only expenditures which were incurred for the production can be recorded as production costs. Refunds and credit notes received for discounts, rebates, invoicing errors, and purchase returns must be credited to the production costs; similarly, proceeds from the sale of props and other production assets must be deducted from the costs presented in the cost report. In cases where props and other productions assets are kept in inventory for future productions, they must also be deducted, at fair market value, from the costs presented in the cost report. Completion bond expenditures must reflect any "no-claims rebate" received (the amount reported must be net after rebate). Amortization of series costs must be allocated to specific cost categories.
  - v) The Film Commission may authorize the use of a sampling method for purposes of performing the audit. In that case, the selection of the costs and eligible amounts incurred to be tested must be made using only an acceptable **statistical** sampling method (i.e. dollar-unit sampling, CMA, PPS, etc.) and **not** a non-statistical method (i.e., scopes, judgmental, etc.).
  - vi) The Film Commission may request to the Auditor any information deems necessary for purposes of validating the information presented by the Auditor as part of the Agreed Upon Procedures.
  - vii) The notes to the Audit Report must include the following disclosures and schedules:
    - 1. The amounts spent in each calendar year for both the overall expenditures and the Puerto Rico employee payroll.
    - 2. All non-Puerto Rico costs must include the budget item and the amount of the transaction (if there are no non-Puerto Rico costs, the cost report must include a note to that effect). Qualified Nonresident costs must be broken down between Above the Line and Below the Line costs.

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3. All related party transactions (as defined by the accounting standards), and include the following: (i) the name of the related party, (ii) the nature of the relationship between the related party and the motion picture production company, (iii) the nature of the transaction, and (iv) the amount of the transaction. If there are no related party transactions, the cost report must include a note to that effect.
  4. The amount of accounts payable, accrued charges and deferrals must be presented separately as of the ending date of the Audit Report. If there are no accounts payable, accrued charges or deferrals, the Audit Report must include a note to that effect.
  5. All sources of funds that were used to finance the production must be disclosed, including any non-monetary transactions that were included in the cost of the production. Non-monetary transactions must be disclosed at fair market value.
  6. The nature of the services provided and the consideration given in exchange for the services must be disclosed. If there were no non-cash transactions, the cost report must include a note to that effect.
  7. An assertion that any disbursements for repairs and construction resulting from the damages caused by a natural even such as hurricanes, floods or earthquakes, are excluded from the costs reported as eligible.
  8. An assertion that estimated costs of the time invested by the producer or any partner of the Applicant are excluded from costs reported eligible.
  9. An assertion that cost allocations were made in accordance to the allocation method determined by the Company.

## **VII. DEROGATORY CLAUSE**

The provisions of this Circular Letter shall be effective immediately and shall replace entirely Circular Letter 12-08.

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April 1, 2016  
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For additional information related to the provisions of this Circular Letter, please contact the Film Commission at (787) 754-4747.

Sincerely,



Alberto Bacó Bagué, Esq.

Secretary

Department of Economic Development and Commerce

Date 4/1/16

