

November 21, 2014 www.mcvpr.com

SECURITIES AND TAX ALERT

New Private Equity Funds Act Enacted

On November 12, 2014, Senate Bill No. 862 was signed into law by Governor García-Padilla and became Act. No. 185, known as the new Private Equity Funds Act (the "Act"). As part of his Administration's efforts to spur capital investment and economic development, the Act allows for domestic or foreign investment vehicles structured as partnerships and limited liability companies to elect to be treated as a fund under the Act ("Fund") and to obtain tax benefits to Fund investors, among others, under the Puerto Rico Internal Revenue Code of 2011, as amended, (the "Code").

Below is a summary of the key provisions of the Act.

I. Eligibility

Eligible Funds include any domestic ("PR-PEF") or foreign ("Foreign-PEF") partnerships or limited liability companies engaged in the business of investing in securities that are non-publicly traded securities at the time of investment ("Private Securities"), and which comply with the following requirements ("Eligibility Requirements"):

- Have an office located in Puerto Rico.
- Be engaged in a trade or business in Puerto Rico within the meaning of the Code ("ETB-PR").
- Have investors that qualify as "accredited investors" under the Act.
- Have an advisory board consisting of at least one of its investors or limited partners.
- Use a registered investment adviser that is ETB-PR with a business office in Puerto Rico.
- Minimum capital of \$10 million within 24 months of issuance, and thereafter.
- *At least* 80% invested in Private Securities and *up to* 20% in allowable short-term investments.
- Within 4 years from inception and thereafter, restrict investment in any one business and affiliates to 20% of Fund's capital.
- For Foreign-PEFs: at all times derive *at least* 80% of gross income from Puerto Rico sources or income effectively connected or treated as such under the Code (the "80% PR Gross Income Rule").
- For Foreign-PEFs: within 4 years from inception and subsequently, maintain *at least* 15% of Fund's capital invested in Private Securities that comply with the 80% PR Gross Income Rule during the prior 3 years period.
- For PR-PEFs: within 4 years from inception and thereafter, maintain *at least* 60% of Fund's capital invested in either (i) Private Securities that comply with the 80% PR Gross Income Rule during the prior 3 years period, or (ii) exempt investment trusts under Section 1112.01 of the Code.

II. Election of Benefits under the Act

Election for treatment as a Fund under the Act must be notified to the Puerto Rico Secretary of Treasury no later than the last day of 3rd month after the Fund inception date. Failure to comply with any of the Eligibility Requirements during any taxable year will disqualify the Fund from tax benefits during the year of breach. However, disqualification for a particular taxable year does not prevent a Fund from benefiting again from the Act's provisions for subsequent taxable years. The Puerto Rico Secretary of Treasury shall issue regulations setting forth the procedures for such election.

III. Effect of Election and Benefits

Certain income derived by the Fund is exempt from tax under the Code. General information and withholding tax provisions under the Code are applicable.

The provisions under Chapter 7 of the Code applicable to partners in a partnership apply to investors of electing Funds, including the recipients of carried interest. For investors, interest and dividend income received from the Fund is taxed at a fixed rate of 10%, while capital gains are exempt from tax. Also, capital gains from the sale of ownership interest in a Fund are taxed at a fixed rate of 5%, unless proceeds from the sale are reinvested in a PR-PEF. In addition, investors that are Puerto Rico residents benefit from the availability of deductions for net capital losses and additional deductions with respect to their initial investment in an eligible Fund subject to certain limitations. Interest and dividend income received by general partners, registered investment advisors and private equity funds are taxed at a rate of 5%, while their capital gains are taxed a rate of 2.5%.

IV. Provisions with respect to other laws

The Act does not affect any tax treatment that may be obtained by Fund participants under the provisions of any current or future incentives' law, including, without limitation, the Act to Promote Export Services (Act 20-2012), and the Act to Incentivize the Transfer of Investor Individuals to Puerto Rico (Act 22-2012). The Act exempts Funds from any municipal license, personal or real property taxes under the Municipal License Tax Act (Act 113-1974) or the Municipal Property Tax Act (Act 83-1991), as applicable, and from the provisions of the Investment Company Act of Puerto Rico (Act 6-1954) and the Puerto Rico Investment Companies Act of 2013 (Act 93-2013).

V. Important Compliance, Operations and Disclosure Requirements

Funds must comply with all applicable provisions of federal and Puerto Rico securities laws, and will be subject to examinations by the Office of the Commissioner of Financial Institutions. In addition, Funds must comply with specific operational and disclosure requirements listed under the Act, including requirements for the extension of the terms of the Fund.

If you have any questions or comments, or wish additional information regarding the above matters, please contact any of the following attorneys:

Samuel T. Céspedes Jr.	787.250.2610	scs@mcvpr.com
Roberto L. Cabañas	787.250.5611	rlc@mcvpr.com
Rubén Méndez-Benabe	787.250.2621	rmbx@mcvpr.com
Ricardo J. García Negrón	787.250.5694	rjg@mcvpr.com