**Puerto Rico legislature moves toward sales and use tax distribution changes**
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The Puerto Rico legislature anticipates passing a bill that would funnel a portion of sales tax revenue directly to the general fund while sidestepping the **Puerto Rico Sales Tax Financing Corporation** (COFINA), said spokespeople for Senate President Eduardo Bhatia and Speaker of the House Jamie Perello.

On 29 May Governor Alejandro Garcialla Padilla signed an overhaul to the COFINA tax which raised the rate to 11.5% from 7%, according to prior reports. The increase is effective from 1 July 2015 to 1 April 2016, when it is expected to be replaced by a value-added tax. The 4.5% increase is expected to generate USD 1.2bn in tax revenue.

House Bill (HB) 2505 would divert the new revenue generated by the 4.5% into the general fund and not into COFINA, which has historically been the first stop for sales tax revenue, giving COFINA structural seniority to the government general fund, aspreviously reported. Under the new law, 6% of sales tax revenue would still go to COFINA first and be used to service USD 16.7bn in bond debt.

Puerto Rico already collects a 1% sales tax, bringing the islands total to 11.5%, which goes toward the **Municipal Financing Corporation** (COFIM). This amount was added in January 2014 with the intent of bonding out the 1%, as previously reported. COFIM has not issued bonds.

The market views the potential change in HB 2505 as slight negative, said several analysts and a trader. That a portion of sales tax revenue sluices to the government directly undermines the COFINA security interest, the first analyst added. A provision in the COFINA structure shields sales tax revenue from a potential claw back from the government in the event it goes searching for available resources to buttress its finances.

"I think COFINA will be fine," said one bondholder. "But it's a lot of headache though following the stripping of the revenue stream."

Puerto Rico has not been consistent with many of its regulations so this should not come as a surprise, said a second analyst. The market has likely already priced this sort of risk in because it's known that Puerto Rico has financial difficulties at the start of the year.

"These changes are necessary to reach the objective of the recently adopted legislation to add funds immediately to the central government .... It's probable that the Treasury will not have the necessary liquidity to operate during the first trimester of FY16," said Melba Acosta, **Government Development Bank** president, in the bill.

The commonwealth is trying to smooth out revenues with this move, said the first analyst. It wants to decrease its reliance on tax revenue anticipation notes.

"My personal view is that it would be a slight negative in that it would create the appearance of [sales tax funds] being available to the GO," said a trader.

The conversation is still swirling around the same COFINA and claw-back questions, said Andrew Gadlin, an analyst at Odeon Capital.

"I don't think legally it has much impact but I think perception matters," Gadlin said.

HB 2505 was given a positive recommendation by Rafael Hernandez Montanez, chairman of the House Finance Committee, according to the bill. That commission returned the bill to the house on 5 June, according to the website for the Puerto Rico legislature.

A USD 259.98m tranche of Series 2011C sales tax revenue bonds which mature in 2040 last traded in round lots on 29 may between 69.6 and 69.9 yielding 7.7% to 7.8%, according to *Electronic Municipal Market Access*.

The bonds were last rated B by Fitch Ratings on 26 March, Caa2 by Moody's Investor Service on 21 May and CCC+ by Standard & Poor's on 24 April.

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