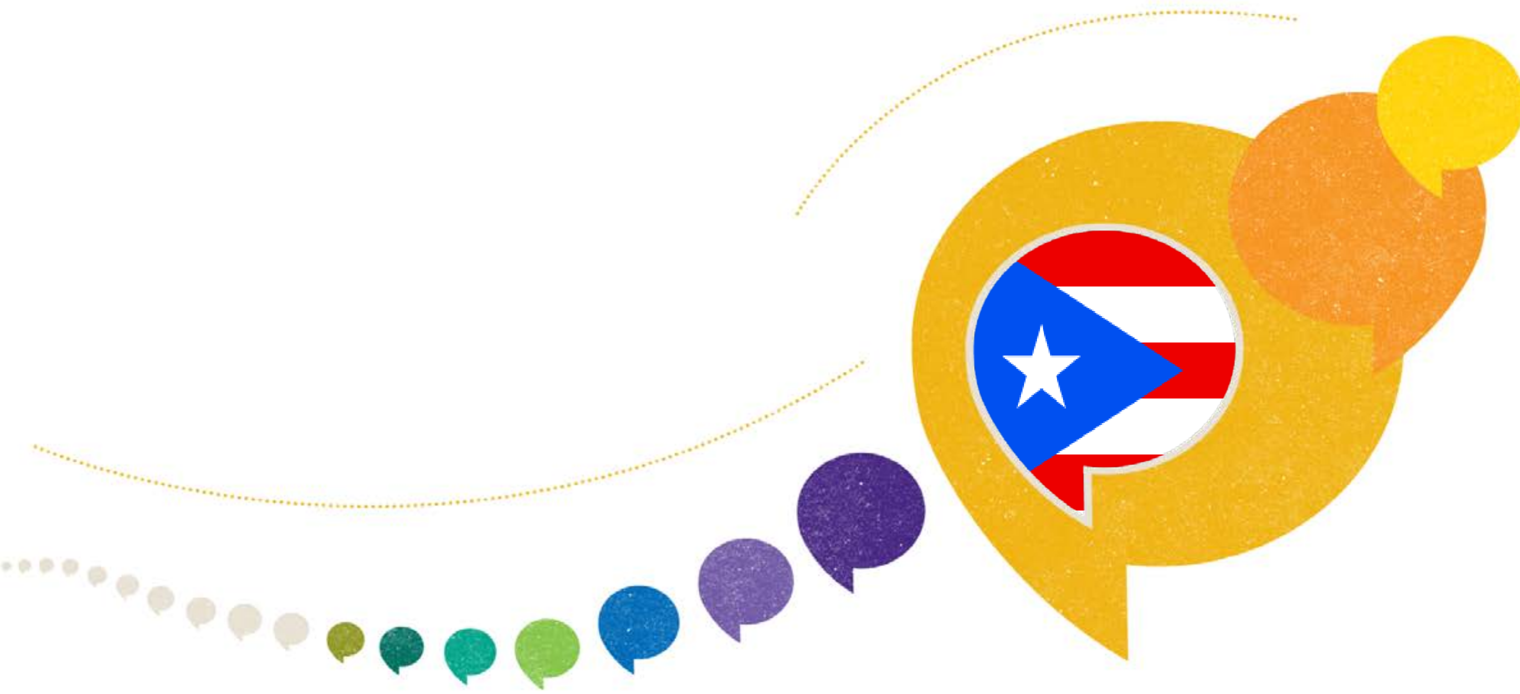
Kevane Grant Thornton

An instinct for growth™

Doing business in Puerto Rico

2016

If you are planning on doing business in Puerto Rico, information on the legal, accounting and taxation framework are essential to keep you on the right track.



Content

"We want our clients to experience the difference. Our partners work closely in the planning and execution of an engagement, which allows us to help our clients achieve their personal and business goals".

Luis Carlos Marcano, Managing Partner
Kevane Grant Thornton

Foreword

Currently, Puerto Rico, a territory of the United States of America ("US"), provides the perfect environment to invest. In addition to a strong legal framework, highly skilled bilingual workforce and outstanding infrastructure, the aggressive tax incentives that Puerto Rico offers, make the island a highly attractive destination to conduct businesses. Nevertheless, it is essential that prospective investors obtain proper and sound advice concerning regulatory and legal issues arising from the conduct of business in Puerto Rico.

Kevane Grant Thornton has prepared this guide to assist those interested in doing business in Puerto Rico. It does not cover the subject exhaustively but is intended to answer some of the important, broad questions that may arise. When specific problems occur in practice, it will often be necessary to refer to the laws and regulations of Puerto Rico and to obtain appropriate accounting and legal advice. This guide contains only brief notes and includes legislation in force as of May 2016.

About Kevane Grant Thornton and Grant Thornton International LTD

Kevane Grant Thornton is the Puerto Rico member firm of Grant Thornton International Ltd offering tangible solutions to its clients through a wide variety of specific services aimed at optimizing their business's yield. The firm has a staff of over 125 professionals who have the right mix of skills and experience to help its clients to achieve success promptly and efficiently.

Kevane Grant Thornton's service is based on personalized assistance, commitment to clients, and knowledge of their business and awareness of their needs, hence providing its clients with concrete solutions implemented with modern technology. In addition to these advantages, resources provided by Grant Thornton International include international-level specialists. Among services provided are accounting and auditing, business and government advisory, tax compliance and advisory, and business processes outsourcing.

Grant Thornton International is one of the world's leading organizations of independently owned and managed accounting and consulting firms. These firms provide assurance, tax and specialist advisory services to privately held businesses and public listed and public sector entities. Clients of member and correspondent firms can access them in more than 130 countries and consistently receive from its 42,000 personnel a distinctive, high quality and personalized service wherever they choose to do business. Grant Thornton International strives to speak out on issues that matter to business and which are in the wider public interest and to be a bold and positive leader in its chosen markets and within the global accounting profession.

The strength of each local firm is reflected in the quality of the international organization. All Grant Thornton International member firms share a commitment to providing the same high quality service to their clients wherever they choose to do business.

Country profile

Summary

Basic data	
(2015 estimates, except where noted)	
Population	3.598 million
Area	9,104 sq. Km (3,425 sq. mi)
GDP (purchasing power parity)	US$ 61.46 billion (2013 est.)
GDP – per capita (PPP)	US$ 28,500 (2013 est.)
Exports	US$ 68.19 billion
Imports	US$ 47.77 billion
Literacy rate	93.3%
Life expectancy	79.25 years
Urban population	93.6%
Local currency	US Dollar $

Geography and population

Puerto Rico (also referred to herein as the "Island") is the most eastern of the Greater Antilles between the Caribbean and North Atlantic Ocean, about 1,050 miles southeast of Miami. By air, it is just over 3 hours from New York. According to the 2010 US Census, Puerto Rico has a population of approximately 3.7 million people and is the third-most populated US state/territory.

San Juan is one of the largest and best natural harbours in the Caribbean. Many small rivers and high central mountains ensure the land is well watered. The south coast is relatively dry and there is a fertile coastal plain belt in the north.

Political and legal system

A self-governing Commonwealth within the US constitutional system, the Island's government consists of the Executive, Legislative and Judicial branches. General elections are held every four years. There are 78 municipalities on the Island, each with a locally elected mayor and assembly.

Although Puerto Ricans are US citizens, residents pay no federal income tax on their Puerto Rico source income, and do not vote in presidential elections. As citizens, Puerto Ricans do not require a visa to travel, live and/or work in the US.

Language

The primary language is Spanish. English is spoken and used as business language and it is required in all federal matters. About a quarter (25%) of the population speaks English, and the language is spoken in all major tourist areas.

Business hours / time zone

Department stores and malls are generally open Monday through Saturday from 9 am to 9 pm. Many stores also open on Sunday from 11:00 am to 7:00 pm.

The working hours in Puerto Rico in the private sector are generally from 8:00 am/9:00 am to 5:00 pm with a break for lunch of 1 hour, from Monday through Friday.

Banks are open from 8:30 am to 4:30 pm.

Government offices are open from 8:30 am to 4:30 pm.

Time in Puerto Rico is Atlantic Standard Time (AST) UTC/GMT – 4 hours all year around, which means that the Island does not observe Daylight Saving Time.

Public holidays

Puerto Rico celebrates religious, local and US holidays. The following holidays are observed in Puerto Rico. If the holiday falls on a Sunday is observed on the following Monday:

Holidays	Day
New Year's Day	January 1
Epiphany - Three Kings' Day	January 6
Martin Luther King Day	3rd Monday of January
President's Day	3rd Monday of February
Emancipation Day	March 22
Good Friday	March or April
Easter Sunday	March or April
Memorial Day	4th Monday of May
US Independence Day	July 4
Puerto Rico's Constitution Day	4th Monday of July
Labor Day	1st Monday of September
Columbus Day	October 12
Election Day	Every four years
Veteran's Day	November 11
Puerto Rico's Discovery Day	November 19
Thanksgiving Day	4th Thursday of November
Christmas Day	December 25

Economy

Diversification of the economy, coupled with investments and funding from the US, has created an economic environment that does not rely solely on tourism for financial prosperity. A diverse industrial sector has surpassed agriculture as the primary source of economic activity and income. Encouraged by duty-free access to the US and by tax incentives, US business have invested heavily in Puerto Rico since the 1950s. Furthermore, following recent incentives focused on export of services, Puerto Rico is betting to surpass the current economic challenges by promoting Puerto Rico as an international services center with high concentration on technology and novel industries. Tourism continues to be an important source of income.

Economic growth

Over the last years the Puerto Rico's economy has suffered a slowdown in its economic growth due to the on-going recession. Although, economists' analysis tend to believe that this reduction in the economy has ceased, the prospects for the year 2016 and future years tend to be clouded by the fact that the Island's economy is not isolated from that of the rest of the world. Nevertheless, Puerto Rico has the wherewithal for achieving sustainable development in its manufacturing and advanced services foundations, its skilled workforce, and the fact that there is little to no country risk.

Employment levels

The Island's top-notch labor force has become the primary asset of Puerto Rico's diverse manufacturing sector and continues to be one of the main reasons established companies continue to operate locally and new ones are drawn to the Island. According the Puerto Rico Department of Labor and Human Resources, as of December 2015 Puerto Rico's labor-force participation rate was at 40.4%; its employment was 1.012 million people strong, an increase of 7,000 when compared with December 2014; and there were 140,000 people unemployed for an unemployment rate of 12.2%, a reduction from the 13.7% in December 2014.

Living standards

Since Puerto Rico is a territory of the US, minimum wage laws apply.

Cost of living

According to the Council for Community and Economic Research (C2ER) the cost of living in Puerto Rico is approximately 13% higher than in the US in average. In comparison with the US average, grocery prices are 22.7% higher, utilities are approximately 85% higher, and housing and transportation are slightly lower. The average cost of healthcare in Puerto Rico is 55.6% of the average cost of healthcare in the US.

Visas

As a territory of the US, immigration and work visas in the Island are governed by federal law, through the US Department of Homeland Security's Citizenship and Immigration Services. Foreign nationals with Green Card, who become permanent US residents, are permitted to work indefinitely in US, including Puerto Rico. In addition to permanent residents US laws allow some foreign nationals to work in its States and Territories. Below are permanent worker visa preference categories:

Preferences	General Description	Labor Certification Required?
First Preference EB-1	This preference is reserved for persons of extraordinary ability in the sciences, arts, education, business, or athletics; outstanding professors or researchers; and multinational executives and managers	No
Second Preference EB-2	This preference is reserved for persons who are members of the professions holding advanced degrees or for persons with exceptional ability in the arts, sciences, or business	Yes, unless applicant can obtain a national interest waiver
Third Preference EB-3	This preference is reserved for professionals, skilled workers, and other workers	Yes
Fourth Preference EB-4	This preference is reserved for “special immigrants,” which includes certain religious workers, employees of U.S. foreign service posts, retired employees of international organizations, alien minors who are wards of courts in the United States, and other classes of aliens	No
Fifth Preference EB-5	This preference is reserved for business investors who invest $1 million or $500,000 (if the investment is made in a targeted employment area) in a new commercial enterprise that employs at least 10 full-time U.S. workers	No

For additional information please visit the U.S. Citizenship and Immigration Services website.

Regulatory environment

Restrictions on foreign ownership
Title and rights of ownership may be held and exercised by one or more individuals, corporations, limited liability corporations, partnerships and trusts, including foreign persons and corporations and other foreign legal entities.

Government approvals and registration
All merchants seeking to engaged in trade or business in Puerto Rico must register with the Registry of Businesses at the Puerto Rico Treasury Department at least 30 days prior to commencing business operations.

Competition rules/consumer protection
Puerto Rico Department of Consumer Affairs aims to defend and implement the rights of the consumer, restrain inflation and oversee prices on consumer goods and services. The Department has the power to impose administrative fines, issue subpoenas, and represent the public consumer.

Import and export controls
US export controls restrict a wide array of items; except for exports to US territories and possessions, all exports from the USA are subject to an export "license".

Price controls
Price control matters in Puerto Rico are typically regulated by the Puerto Rico Department of Consumer Affairs.

Use of land
The Puerto Rico Planning Board and the Rules and Permits Administration are the government agencies in charge of the regulation of economic planning and land use zoning in Puerto Rico.

Exchange control
Puerto Rico does not have any exchange control regulations.

Government incentives
The Puerto Rico Government offers a range of incentives in economic development areas of interest like: agriculture, capital investment funds, feature films, international banking, international insurers, solid waste disposal facilities, tourism, and manufacturing.

Insurance

Summary
The Office of the Commissioner of Insurance (“OCS” for its acronym in Spanish) is the Puerto Rico agency in charge of safeguarding the public interest, ensuring the solvency of insurers and health insurance organizations, as well as addressing situations referred by consumers and ensuring full compliance with regulatory requirements. Title 26 of the Puerto Rico Code governs the insurance sector.

Important Insurance Code Provisions
According to the OCS, the following entities must be licensed:

- risk-bearing entities: authorized insurers and reinsurers, health services organizations, eligible surplus lines insurers, service contract providers, auto clubs, and settlement agreement providers (currently, third-party administrators need not be licensed to operate in Puerto Rico)
- authorized service companies: rating organizations and advisory organizations
- licensed intermediaries: producers, authorized representatives, general agent/manager, surplus lines brokers, life settlement agreement brokers, adjusters and attorneys in fact.

Mandatory Insurance Requirements
The Insurance Code, as in most of the US, establishes a joint underwriting association for vehicular liability insurance, and vehicle owners are required to obtain such insurance upon the issuance or renewal of vehicle licenses.

Finance

Summary

The Office of the Commissioner of Financial Institutions ("OCIF" by its acronym in Spanish) is Puerto Rico's financial services sector regulator, and is responsible for formulating public policy and regulating and auditing the sector's institutions and ensuring compliance with regulatory mandates.

Banking system

Puerto Rico banking system is regulated under US laws by the Federal Deposit Insurance Corporation (FDIC).

Commercial banks organized in Puerto Rico are governed by the Banking Law of Puerto Rico. Based on their particular circumstances, banks organized in Puerto Rico or doing business in Puerto Rico are also subject to various federal banking laws and the supervision of various federal banking agencies.

Capital markets

Puerto Rico does not have its own Stock Market. However, some of its larger corporations are listed on US stock markets.

Other sources of finance

The Government Development Bank serves as a bank, fiscal agent and financial advisor to the Commonwealth of Puerto Rico and its various instrumentalities. Its main goal is to safeguard Puerto Rico's fiscal stability and promote its competitiveness to transform its economy. Although the Government Development Bank's primary client is the Puerto Rico Government, its subsidiaries and affiliates offer valuable services to the private sector.

Imports

Summary

The US is the main trading partner of Puerto Rico and accounts for nearly 90% of its exports and 45% of its imports. Chemicals, machinery and equipment, clothing, food, fish and petroleum products are among the main items constituting Puerto Rico imports.

Import restrictions

Puerto Rico is heavily dependent on maritime transportation for the moving of goods to and from the Island. As such, it is subject to the Jones Act, which states that the maritime transportation of goods between points in the US must be carried by vessel that are owned by US citizens and registered under the US flag with a coastwise endorsement, which in turn requires that said vessels be built in the US.

Customs duties

Import duty and taxes are due when importing goods into Puerto Rico whether by a private individual or a commercial entity. The valuation method is Free on Board (FOB) which means that the import duty payable is calculated exclusively on the value of the imported goods. However, some duties are based part in value and part in quantity. In addition to duty, imports may be subject to Sales and Use Tax (SUT) or excise taxes. Duty rates can be ad valorem (as a percentage of value) or specific (dollars/cents per unit). Duty rates vary from 0% to 37.5%, with the average duty rate being 5.63%.

Basic Data	
Imports	$47.77 billion (2015 est.)
Imports – commodities:	Pharmaceuticals, chemicals, petroleum products, food, computer and electronic products, machinery
Imports – partners:	USA, Ireland, Singapore, Japan and Virgin Islands

Business entities

Summary

Once a group of investors or an entity decides to come to Puerto Rico to do business, its management must decide which type of entity will better serve their purposes. Puerto Rico Corporate and Tax Laws allow several options. The following constitutes a brief summary of these alternatives.

Limited liability companies

Any natural or judicial person may organize a limited liability company in Puerto Rico. The articles of organization are required to be filed with the Department of State, where it becomes available for public inspection. Every limited liability company is required to maintain in Puerto Rico a registered office and a resident agent, who can be an individual resident in Puerto Rico, a domestic corporation, or a foreign corporation authorized to do business in Puerto Rico. The fee required by the State Department is $250 for a certificate of authorization.

For income tax purposes, limited liability companies will be taxed in the same manner as corporations. Nevertheless, LLCs may elect to be treated as partnership by filing Form 6045 Partnership or LLC Classification Notification or Election on or before the last day of the third month of the taxable year for which as a flow-through notification or election will be effective. However, if the LLC is treated as a flow through or disregarded entity for US or other foreign country income tax purposes, it must be treated as such for Puerto Rico income tax purposes. This exception does not apply to those LLCs that were operating under a tax grant as of the effectiveness date of the Internal Revenue Code for a New Puerto Rico of 2011 (the “2011 Code”).

Corporations

Establishing a corporation

Puerto Rico’s General Corporations Law provides for the creation of for-profit, non-profit, domestic, foreign, close and professional corporations. Corporations are available for any lawful business, with very limited exceptions. In general, corporations may be organized by one or more persons and/or judicial entities.

Filing requirements

Domestic

Puerto Rico’s General Corporation Law is based on Delaware’s. In general terms, a corporation is an entity separate and distinct from its shareholders, directors, and officers. It has the power to enter into contracts, hold property, and sue and be sued on its own name; it also has continuity of life and free transferability of ownership interests.

Puerto Rico corporations must maintain a designated principal office and agent in Puerto Rico for service of process.

Corporations must file an annual report on or before April 15. Said report must be filed electronically by an officer of the Corporation or authorized representative, and if the annual volume of business exceeds $3,000,000, must be accompanied by the Corporation's balance

sheet at the close of the preceding fiscal year, audited by a certified public accountant licensed in Puerto Rico who cannot be a stockholder or employee of the corporation. Each annual report must be accompanied by a $150 fee.

Corporations can merge or consolidate with one another (in a *merger*, one of the corporations survives; in a *consolidation*, a new corporation is formed). In either event, the stockholders and creditors of the non-surviving corporations become stockholders and creditors, respectively, of the surviving corporation, and the surviving corporation takes on the rights and liabilities of the merged/consolidated corporations. Where permitted by the law of a foreign corporation's state of incorporation, Puerto Rico law allows for merger with a non-Puerto Rico corporation.

Foreign

A foreign corporation - that is, one that is organized under the laws of any country but Puerto Rico - may not conduct business in Puerto Rico prior to receiving authorization from the Secretary of State. In order to obtain such authorization, certified copies of the corporation's charter and certificate of incorporation and of the Certificate Required to do Business in Puerto Rico must be filed with the Department of State. The fees required by the State Department to process and issue the certificate of registration are $150. Legal process against the corporation may be served on its authorized resident agent, who must be either a natural or judicial person residing in Puerto Rico, but cannot be a stockholder, officer or director of the corporation.

A foreign corporation may be engaged in trade or business in Puerto Rico as a division or branch of that foreign corporation, or as a separate corporation or subsidiary. Resident foreign corporations are taxed in Puerto Rico on their Puerto Rico source income and on any effectively connected income at the graduated tax rates as any domestic corporation.

Branch

Income taxation of a US branch is the same as for a US subsidiary. The only difference will be that a deemed dividend distribution tax (known as a "branch profit tax" or "BPT") will be assessed on the branch upon any advances made to its home office. The BPT rate is 10% of the "dividend equivalent amount". Broadly speaking, the BPT would be imposed if the earnings and profits derived by the Branch were not reinvested in Puerto Rico as of the end of the taxable year. Comparing the net equity at the end of the taxable year and the net equity at the beginning of the taxable year makes the determination whether the amount was invested or reinvested.

Corporate dissolutions

Dissolution of a corporation in Puerto Rico is accomplished by following the procedures established in the General Corporate Law. This process includes the filing of a Certificate of Dissolution with the Puerto Rico Department of State and the withdrawal from the several government agencies in which the dissolve entity holds a filing requirement.

Sole proprietorships

A sole proprietorship is a business owned by a single individual who chooses not to form a partnership, corporation, or limited liability company. There are no special legal requirements for creating a sole proprietorship other than the normal requirements for starting a trade or business (this includes obtaining an Employer Identification Number for those sole proprietorships with employees other than the owner), registering with the Registry of Businesses at the Puerto Rico Treasury Department. Sole proprietorships are not juridical entities and cannot enter into contracts or sue or be sued in their own name. Accordingly, a sole proprietorship provides no liability protection for its owner(s) and generally terminates upon the death of it owner(s). Likewise, it is not taxed separately, and all income is passed through to the owner(s). The owner is taxed at the appropriate individual rate.

A sole proprietorship may operate under a trade name. Trade names may be recorded at the Trade Name Registry for additional protection.

Partnerships

General partnerships

A partnership is established by the agreement between two or more persons, under a common name or not, to be engaged in a joint venture for profit, whether or not its constitution is set forth by public deed or private document. Partnerships will include any unincorporated organization engaged in trade or business.

Under the provisions of the 2011 Code, partnerships are flow through entities. Rules similar to those applying to partnerships in the US were adopted.

Civil code partnerships

A civil code partnership is a contract by which two or more persons bind themselves to contribute money, property, or industry to a common fund or enterprise, with the intention of dividing the profits among themselves. There is no special formal requirement for the creation of a civil partnership. Nevertheless, for a civil code partnership to acquire real property in Puerto Rico, it must utilize a deed form to create the partnership. The civil partnership does not need to register with any government agency to be created or constituted.

A civil code partnership is automatically dissolved by the death, civil interdiction, or insolvency of a partner (unless otherwise provided for in the partnership agreement), or when the business for which it was constituted ends. A civil partnership will not dissolve upon the withdrawal of a partner if the duration of the partnership is fixed and has not expired.

The partners in a civil code partnership have a subsidiary obligation with respect to the debts of the civil partnership. The creditors of a civil code partnership must first try to collect from the funds of the partnership. Only if such funds are insufficient to pay the debts owed to the creditors, may the creditors move to collect from the partners. In such cases, the partners will be severally liable for the debts of the partnership.

Commercial code partnerships

Commercial partnerships - or partnerships formed under Commerce Code provisions - are defined as those in which two or more persons obligate themselves to join funds, properties and/or industry to obtain profits. This definition is almost identical to the definition of partnership under the Civil Code, but commercial partnerships must meet certain formal requirements, including being executed in deed form and registering with the Mercantile Registry (failure to record eliminates the protection of the partnership contract as to third-party claims). The recording fee in the Mercantile Registry is $1.00 per $1,000 of capital, up to $10,000 and 50¢ per $1,000 above $10,000. The Mercantile Registry only acts as a registry and has no supervisory duties. There is a Mercantile Registry in each Property Registry, and partnerships must be recorded in the Registry located in the municipality where the principal office of the business is located.

There are two types of commercial partnerships: general partnerships and limited partnerships. A general partnership is one in which all the partners bind themselves, collectively and under a firm name, to share the same rights and obligations in such proportions as they may establish. The partners of a general partnership are personally and jointly liable for all the liabilities of the partnership.

Limited Partnerships

A limited partnership is made up of managing and limited partners. Managing partners run the affairs of the partnership and are jointly liable for the debts and obligations of the partnership. Limited partners are passive investors and may not participate in the management of the partnership, and their liability for the debts and obligations of the partnership is limited to their contribution to the partnership.

Limited liability partnerships

Two or more natural persons, including those rendering professional services, can form a limited liability partnership. They must register the limited liability partnership with the Department of State by filing a certified copy of the constituent deed accompanied by a $100 fee. Registration is valid for one year and must be renewed annually by filing a renewal application and a $110 voucher. The name of the partnership must include the words “limited liability partnership” (*sociedad de responsabilidad limitada*) or “LLP”, “L.L.P.”, or “S.R.L.”

Generally, a partner in a limited liability partnership is not personally liable for the debts and obligations of the partnership or for negligent or unlawful acts of another partner or employee not supervised by the partner, provided he had no prior knowledge of such acts. However, the partner may be held personally liable for partnership debts and obligations that arise out of an error, omission, negligence, incompetence, or illegal act committed by that partner or in which that partner was involved, directly or through any person under his or her control or supervision or of which that partner had notice or knowledge.

Special partnerships

A partnership or a corporation that meets certain requirements may have elected to be treated as a special partnership (commonly referred to as “*Sociedad Especial*” in Spanish) for income tax purposes. This treatment allows for a pass through of income and losses to the owners of the entity, eliminating the double taxation applicable to regular corporations. In order to qualify, at least 70% of the gross income of the entity must be from Puerto Rico sources and 70% must be from the performance of one or more of the qualifying activities (i.e. land development, tourism, building and structures lease, sale or rehabilitation of building structures, manufacturing which generates substantial employment, exportation of goods or services, construction or operation of maintenance of public roads and adjoining facilities, agriculture, film production). The special partnership election is not available for years commencing after December 31, 2010. Those elections made in prior years are still effective.

Subsidiaries

As previously mentioned, a foreign corporation may be engaged in trade or business in Puerto Rico as a division or branch of that foreign corporation or as a separate corporation or subsidiary. A foreign corporation that is engaged in trade or business in Puerto Rico must treat the following income as income effectively connected to its trade or business in Puerto Rico:

- all income from sources within Puerto Rico; and
- income attributable to an office or other fixed place of business in Puerto Rico.

A 10% tax on any deemed dividend will be imposed to a foreign owner of a corporation doing business in Puerto Rico, regardless of the actual payment of dividend. The dividend amount will be the lesser of: (i) average value of foreign assets or (ii) accumulated earnings and profits at year end *excluding* accumulated earnings and profits from Industrial Development, Agriculture or International Banking. The tax calculation will be included on the Corporation's current year tax return. A credit for said tax will be allowed against the tax to be withheld and paid upon actual distribution, with any unused amount to be carried forward to future years.

Joint ventures

A joint venture is formed between two or more parties who agree to undertake economic activity together and share in the revenues, expenses, and control of the enterprise. The venture can be for one specific project only, or a continuing business relationship. For income tax purposes, it is treated as a partnership.

Trusts

The Puerto Rico Civil Code essentially incorporates the common law of trusts while attempting to harmonize common law and civil law concepts. The Civil Code defines trusts as “an irrevocable mandate whereby certain property is transferred to a person, named the trustee, in order that he may dispose of it as directed by the party who transfers the property, named constituent, for his own benefit or for the benefit of a third party, named the beneficiary.” The Civil Code trust provisions do not establish the extent of the liability of a trust, if any, in relation to the debts of its beneficiaries; common law rules would likely be applied to determine such liability.

Other entities commonly used by foreign investors

Real Estate Investment Trusts

A Real Estate Investment Trust ("REIT") is a tax designation reserved for entities investing in real property that reduces or eliminates corporate income taxes. The term "real property" includes, among other things: hospitals and related facilities; schools and/or universities; public and private housing; transportation facilities and private or public roads; office and residential buildings; buildings occupied by government agencies, departments or corporations of the Government of Puerto Rico; manufacturing buildings and related facilities; recreational centers; parking facilities; shopping facilities and centers; buildings purchased from the Government of Puerto Rico, its agencies and instrumentalities; and hotels.

To qualify as a REIT under the 2011 Code, an entity must:

- be organized as a corporation, partnership, trust, or association;
- have 20 or more shareholders or partners during at least 335 days over a 12-month period;
- be managed by one or more trustees or directors;
- evidence capital contributions with shares of transferable certificates;
- be treated for tax purposes as a Puerto Rico corporation (except for the provisions relating to REITs);
- not be qualified as a financial institution or insurance company;
- file an election to be treated as a REIT or have made such an election for a previous taxable year; and
- at no time during the last half of its taxable year more than 50% of the total value of all outstanding shares or participation certificates can be owned by less than five individuals.

A REIT needs also to comply with the following type-of-income and source-of-income requirements. Specifically, 95% or more of the gross income of the REIT must be derived from:

- dividends;
- interest;
- rents from real property;
- gain from the sale or other disposition of securities or real property (including interests in real property and interests in mortgages on real property) that is not inventory, amounts received or accrued as consideration for entering into agreements either to make loans secured by mortgages on real property or to purchase or lease real property;
- net gains from the sale or disposition of real property;
- qualified temporary investment income; and
- income from the purchase of property to be remodeled and rented.

Moreover, 75% or more of the REIT's gross income must be derived from:

- rents derived from real property located in Puerto Rico;
- interest on obligations secured by mortgages on real property or rights to real property located in Puerto Rico;
- gains from the sale or disposition of real property that does not qualify as inventory;
- dividends or other distributions derived from, and gains derived from, the sale or other disposition of shares of transferable stock, certificates, or participation in another REIT;

- amounts received or accrued as consideration for entering into agreements to make loans secured by mortgages on real property and/or rights to real property located in Puerto Rico, and/or to buy or lease real property and/or rights to real property located in Puerto Rico;
- net gains from the sale or disposition of not prohibited real property; and
- qualified temporary investment income.

REITs organized under the laws of the US or a state of the US ("USREIT") must meet the following requirements to be treated as a REIT under the 2011 Code:

- the USREIT must have qualified as such under the US Internal Revenue Code during the taxable year.
- the USREIT must invest in real property located in Puerto Rico and constructed after June 30, 1995.
- the USREIT must file a sworn statement before the Puerto Rico Treasury Department, no less than 30 days before the first taxable year for which it wishes to be regarded under the 2011 Code as an exempt REIT, with the information required by the Department.

Registered Investment Company

Investment companies are engaged primarily in the business of investing, reinvesting, or trading in securities. They may be organized as corporations, partnerships, associations, joint stock companies, trusts, funds, or any organized group of persons, whether incorporated or not. It is also possible for a receiver, trustee in bankruptcy, or liquidating agent to qualify as an investment company. If certain requirements are met, an investment company may elect special tax treatment.

An issuer is an investment company if it:

- invests in securities with a value exceeding 90% of the total balance of its assets, excluding securities of the US government, the Government of Puerto Rico, political subdivisions, organizations, agencies, or instrumentalities thereof, and cash items;
- invests not more than 25% of the value of its total assets in securities of another issuer, and owns no more than 75% of the outstanding securities of any other issuer;
- does not have fewer than seven (7) shareholders entitled to vote;
- does not have more than 50% of its voting securities controlled by less than two (2) of the holders of such securities; and
- offers its securities to the general public if its outstanding securities are owned by more than one hundred (100) persons.

An investment company must register with the Office of the Commissioner of Financial Institutions before it can offer for sale, sell, or deliver after sale, in Puerto Rico, any security or any interest in a security it issues; control an investment company that does any of the acts listed above; engage in any business in Puerto Rico; or control any company that is engaged in any business in Puerto Rico.

To register, an investment company must:

- maintain its principal office in Puerto Rico;
- hold its annual stockholder meeting in Puerto Rico;
- have at least two (2) directors who are residents of Puerto Rico;
- have a chairman of the board or president, or vice-president and secretary or assistant secretary, who are residents of Puerto Rico;
- invest at least 90% of its total assets, less cash, in Puerto Rico securities (as determined by the Commissioner of Financial Institutions), unless otherwise authorized; and
- have a net worth of at least $100,000 or insure that after registration it will not issue any of its shares until firm agreements are made by not more than twenty-five (25) persons to purchase and pay an aggregate net amount that, added to the net worth of the company, will equal at least $100,000.

Registration requires the payment of a registration fee equal to 0.03% of the total dollar value of the capital stock issued or proposed to be issued.

Other entities

Corporation of Individuals ("N Corporation")

Domestic corporations and partnerships which are owned by 75 or less individuals may elect to be treated as a corporation of individuals for income tax purposes if certain requirements are met: at least 90% of the gross income is derived from an **active** trade or business in Puerto Rico (certain activities do not qualify). The term domestic corporation or partnership includes for these purposes, a US entity which is solely engaged in a trade or business in Puerto Rico. Like special partnerships, a corporation of individuals allows the flow through of income and losses to the owners, eliminating the double taxation of income.

Non-profit organizations

Puerto Rico's General Corporation Law provides for the organization of non-profit corporations. The certificate of incorporation must clearly state that the corporation is organized for non-profit purposes and is not authorized to issue stock.

Instead of shareholders, a non-profit corporation has members who are not personally liable for the debts of the corporation, except by reason of their own acts. However, members have a fiduciary responsibility toward the non-profit corporation similar to that of a director in a regular corporation. Also, the members of a non-profit corporation may elect a governing body (typically called a "Board of Directors") that has the powers and responsibilities of a board of directors of a regular corporation.

Non-profit corporations are required to file their annual report with the Corporation Division of the Puerto Rico Department of State, but they pay a lower fee of only $5, or, in the case of non-profit religious, fraternal, charitable, or educational corporations, no filing fee is required.

Professional Corporation

A professional corporation is formed for the purpose of rendering the type of professional services that require a license from the government of Puerto Rico. All shareholders must be individuals licensed by the government to render the professional services offered by the corporation, and those services must be rendered through the corporation's officers, employees, and agents.

Officers, employees, and agents of a professional corporation are fully and personally liable for any negligent act or omission, unlawful act, or for any wrong conduct that arises from the rendering of professional services on behalf of the corporation, whether committed by such officer, employee, or agent or by any person under his or her direct supervision or control. In addition, the professional corporation is held jointly liable up to the aggregate value of its assets for the negligent or unlawful acts or for the wrong conduct of its officers, employees, and agents while offering professional services on behalf of the corporation. But shareholders who were not involved in the negligent or unlawful act or omission or wrong conduct are not personally liable for the damages caused by them. The professional corporation is not liable for the individual debts of its shareholders. Likewise, shareholders of the professional corporation are not liable for the liabilities of the professional corporation that are not related to negligent acts in the rendering of professional services.

The annual report of professional corporations must certify that its shareholders, directors, and officers are duly licensed, certified, and registered to render the professional services of the corporation in Puerto Rico. Non-Puerto Rico corporations may not qualify as professional corporations.

Labor

Summary

The Puerto Rico Department of Labor and Human Resources is the primary government agency charged with establishing and implementing labor and employment law on the island. Both the federal and local labor and employment laws apply in Puerto Rico. The US Labor Department administers federal labor laws. The US Equal Employment Opportunity Commission administers federal employment discrimination laws. Puerto Rico's labor and employment laws are contained in Title 29 of the Puerto Rico Code, which defines the rights and obligations of employers and employees alike.

Wages

A series of federal and local wage and hour laws apply in Puerto Rico. The federal Fair Labor Standards Act's (FLSA) minimum wage - $7.25/hour – applies to businesses operating in Puerto Rico that:

1. have employees either (a) engaged in commerce or in the production of goods for commerce or (b) engaged in handling, selling or otherwise working on goods or materials that have been moved in or produced for commerce by any person; and
2. have annual gross volumes of sales made or business conducted of at least $500,000.

The Puerto Rico minimum wage applies to all businesses to which the federal minimum wage doesn't apply. The minimum wage for those businesses excluded from the federal minimum wage is equivalent to 70% of the prevailing federal minimum wage.

Payroll Taxes

Under the 2011 Code, employers are required to withhold income taxes at source upon the salaries and wages they paid to employees rendering services in Puerto Rico. The withholding rate is reliant on the employee's personal exemption and dependent credit claimed on the withholding exemption certificate that must be completed by every employer for each employee. There is no salary/wage limitation for the withholding.

Social security

Payroll taxes, including applicable income, Social Security, unemployment and disability taxes are subject to withholding.

Pensions

The Employee Retirement Income Security Act of 1974 (ERISA) governs most types of employee benefit plans, including retirement plans, life and disability insurance, medical reimbursement plans, healthcare plans and severance policies. ERISA requires certain reporting and disclosure, imposes fiduciary duties, and, for most types of retirement plans, establishes coverage, vesting and funding requirements.

Fringe benefits

Holiday pay

In Puerto Rico a number of holidays are customarily recognized and paid. Employers typically not subject to the Closing Law (Act No. 1 of 1989, as amended), will not be required to close during statutory holidays nor grant said holidays with or without pay.

Vacation and Sick leave

Act 180 of 1998 establishes the statutory requirements regarding the accrual and enjoyment of vacation and sick leave. However, there are industries whose vacation and sick leave benefits are determined by the Puerto Rico Department of Labor's mandatory decrees, instead of those granted under Act 180.

Retirement Plan

Though retirement plans can either qualified or non-qualified, only the former is covered under the 2011 Code. Qualified plans are greatly regulated, but bestow preferential tax treatment to the parties involved: (i) the employer gets to deduct contributions to the plan; (ii) the participants defer taxation until the employer's contributions are received, (iii) and the trust who manages the plan is treated as a tax exempt entity.

Worker's compensation

All employers must obtain workers' compensation insurance from the Puerto Rico State Insurance Fund. This insurance provides compensation to employees for work-related accidents or conditions, including occupational diseases. There are exceptions (i.e., when an employee is injured as a result of attempting to commit a crime, being intoxicated or engaging in reckless behavior). A covered employer is not subject to suits for employment-related accidents. The Compensation System for Work Related Accidents Act protects the employee's right to reinstatement for 12 months after an accident.

Healthcare

Both federal and Puerto Rico laws and regulations governing health and safety in the workplace apply to businesses. Both the Occupational Safety and Health Act of 1970 (OSHA), as amended, and its equivalent in Puerto Rico, the Puerto Rico Occupational Safety and Health Act, Law No. 16 of August 5, 1975, impose an affirmative obligation among employers to provide a work environment free from risks, which may cause death or physical harm to employees. Employers are required to provide and ensure the use of protective personal equipment as required or as reasonably necessary, as well as to report serious accidents within eight hours.

Employment protection legislation

As a US jurisdiction, Puerto Rico is subject to federal employment laws, including: Title VII (employers engaged in interstate commerce), Age Discrimination in Employment Act (ADEA), Americans with Disability Act (ADA), Equal Pay Act of 1963 and Title II of the Genetic Information Non-discrimination Act of 2008 (GINA), among others.

Unions

The Labor Management Relations Act of 1947 applies to Puerto Rico in order to regulate relations between employers and unions, union representation, elections, negotiations of collective bargaining agreements and related matters.

Financial reporting and audit

Summary

Puerto Rico employs the same accounting principles prescribed for financial statements as those prescribed in the US by the Financial Accounting Standards Board ("FASB").

Filing requirements

Every business engaged in trade or business, or in the production of income in Puerto Rico, must submit along with its tax returns, financial statements prepared according to the Generally Accepted Accounting Principles ("GAAP") together with an Auditor's Report issued according to the Generally Accepted Auditing Standards in the US ("US GAAP") if it complies with the following requirements:

- if the volume of business during a taxable year is less than one million (1,000,000) dollars, the business will not be required to submit the audited financial statements.
- if the volume of business during a taxable year is equal to or greater than one million (1,000,000) dollars but less than three million (3,000,000) dollars, the business may elect to submit financial statements, accompanied by an Auditor's Report issued by a Certified Public Accountant with license to practice in Puerto Rico. This election is made by entities that want to obtain a Total Withholding Waiver Certificate.
- when the volume of business during a taxable year is equal to or greater than three million (3,000,000) dollars, the business must submit the financial statements required by the 2011 Code, accompanied by an Auditor's Report issued by a Certified Public Accountant with license to practice in Puerto Rico.
- every group of related corporations, comprised of entities engaged in trade or business in Puerto Rico, must submit audited financial statements for every entity within the group with a volume of business of one million dollars or more if the aggregate volume of the group is three dollars million or more.

Individuals and corporate taxation

Summary

As previously mentioned, the 2011 Code is the main body of domestic statutory tax law. It covers income taxes, payroll taxes, gift taxes, estate taxes, sales and use tax and more.

Corporations

Tax rates

Puerto Rico corporations and non-Puerto Rico corporations engaged in trade or business in Puerto Rico face a corporate tax rate composed of two parts:

(1) a "normal" tax, which is fixed at 20%, and
(2) a "surtax."

Normal tax

The first component is calculated by multiplying normal net taxable income times the 20% normal tax rate. The normal taxable net income is the regular net taxable income less 85% of the dividend income received from Puerto Rico corporations (100% in the case of domestic corporations/partnerships, or entities operating under the Small Business Investments Act of 1958).

Surtax

The net income subject to surtax is normal taxable net income minus $25,000. This amount is multiplied by the applicable surtax rate to determine the surtax owed.

Net Income	Surtax
Not over $75,000	5%
$75,001 - $125,000	$3,750 plus 15% of the excess over $75,000
$125,001 - $175,000	$11,250 plus 16% of the excess over $125,000
$175,001 - $225,000	$19,250 plus 17% of the excess over $175,000
$225,001 - $275,000	$27,750 plus 18% of the excess over $225,000
Over $275,001	$36,750 plus 19% of the excess over $275,000

In order to determine the surtax rate, applicable to corporations within a control group or in the case of related entities group, the combined net income of all the entities in Puerto Rico will be taken in consideration.

If the corporation is a member of a controlled group of corporations, the $25,000 deduction to the normal taxable net income must be distributed among the members of the controlled group.

Alternative Minimum Tax

The alternative minimum tax ("AMT") is designed to ensure that corporations with substantial income may not avoid paying a reasonable amount of income tax by using exclusions, deductions, and credits available to them. The Puerto Rico AMT equals the excess of the amount of the tentative minimum tax over the amount of the normal corporate tax plus surtax.

The tentative minimum tax will be the greater of:

- 30% of the excess of net alternative minimum income over the exempt amount, reduced by the alternative minimum foreign tax credit for the taxable year;

or,

- the amount that results from the sum of the following items:
  - 20% over:
    - that amount representing expenses incurred or paid to a related person if such payments are not subject to income tax or withholding at source under the Code in the taxable year in which incurred or paid; and/or
    - that amount representing the transfer of costs or the allocation of expenses of home office located outside of Puerto Rico to a branch if such item was not subject to income tax.
  - purchases of personal property to related parties at the following rates:

Purchaser's Gross Revenue from Trade/Business in PR	Tentative Minimum Tax Rate
$10MM or more but less than $500MM	**2.5%**
$500 Million or more but less than $1,500MM	**3.0%**
$1,500MM or more but less than $2,000MM	**3.5%**
$2,000MM or more but less than $2,750MM	**4.5%**
$2,750MM or more	**6.5%**

Regarding amounts paid to related parties, the 2011 Code limits the deduction of the expenses or charges incurred by a taxpayer with a related party that is not engaged in trade or business in Puerto Rico, if such expenses are not subject to Puerto Rico taxes. On this regard, the Code provides that fifty-one percent (51%) of these expenses are not allowed as a deduction for ordinary tax computation. However, the Secretary of the Treasury may still provide waivers or relief against this disallowance but this authority will be limited to 60% of the expenses.

Also, expenses incurred or paid for services rendered by a non-resident person may not be deducted if the taxpayer has failed to pay the corresponding Sales and Use Tax on said services.

Likewise, the taxpayer may not deduct the cost or depreciation of any good or taxable item, if it fails to satisfy the Sales and Use Tax on said item.

Filing of Tax Returns

Corporate income tax return

All Puerto Rico corporations and all non-Puerto Rico corporations that are engaged in trade or business in Puerto Rico are required to file an income tax return and pay the corresponding Puerto Rico corporate income tax on or before the fifteenth day of the fourth month following the close of its taxable year.

An automatic three-month extension of time will be granted to corporations for the filing of income tax returns if the extension request is filed on or before the due date of the filing of the income tax return. The extension must be filed accompanied by the full balance of the income tax due. Also, as previously noted, if the business volume is equal to or exceeds $3,000,000, the return must be accompanied by audited financial statements for the Puerto Rico operations.

The submission of financial statements on a consolidated or combined basis requirement of every group of related entities engaged in trade or business in Puerto Rico is satisfied by filing Form AS 2652.1: *Apportionment of the Deduction for the Surtax Computation - Group of Related Corporations*. If an entity meets the requirement to file consolidated financial statements, and its business volume exceeded $1,000,000, it may file audited financial statement for its individual activity alone. If its volume of business did not exceed $1,000,000, then the entity is not required to file audited financial statements with the year's return.

Also, Act 163-2014 requires the presentation of supplementary information along with the audited financial statements that will accompany the taxpayer tax returns. The supplementary information is required to be subject to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements.

Estimated Tax

In addition to the corporate income tax return, every corporation engaged in trade or business in Puerto Rico is required to estimate its tax liability for the current taxable year. The estimated tax may be paid in four installments by the 15th day of the fourth, sixth, ninth, and twelfth month.

Consolidated returns

The 2011 Code does not provide for the filing of corporate returns on a consolidated basis.

Use of losses

For purposes of determining the amount of the net operating loss carryover, the 2011 Code defines a *net operating loss* ("NOL") as the excess of deductions over gross income, subject to certain adjustments. In the case of corporations, the adjustments are as follows:

- tax-exempt interest received during the year is added back;
- interest that was not deducted because it was paid or accrued in relation to obligations incurred to acquire or possess obligations that pay tax exempt interests is deducted;
- expenses that were not deducted because they were in relation to the production of exempt income are deducted;

- interest that was not deducted by financial institutions because it was attributed to obligations, acquired by such institutions after December 31, 1987, that paid tax-exempt interest is deducted; and
- the net operating loss deduction carry forward from previous years is not deducted.

For taxable years beginning after December 31, 2014, the NOL carryforward amount is limited to eighty percent (80%) of net income for regular tax purposes and seventy percent (70%) for AMT purposes. The carryforward periods are the following:

Taxable Years incurred	Carryforward Periods
2004 and previous tax years	**7 years**
2005 thru 2012	**12 years**
2013 and forward	**10 years**

Dividends

Dividend distributions by a Puerto Rico corporation are subject to a 15% withholding at source when paid to a domestic corporation, whereas if the distribution is made to a foreign corporation, the withholding rate is 10%. Furthermore, there are provisions to prevent the manipulation of deferring actual distribution in which, depending on the type of assets of the foreign subsidiary and the amount of earnings and profits, a deemed dividend maybe imposed.

Withholding taxes

Wages

Withholding is generally applicable to all of an employee's wages for services performed for an employer. Noncash wages are measured by their fair market value at the time of transfer.

Services

Payments made in the conduct of a trade or business or for the production of income in excess of $1,500 to another person (natural or judicial) for services performed within Puerto Rico are generally subject to a 7% withholding.

Corporations and individuals may get a reduced withholding tax of 3% if they are in good standing with the Puerto Rico Treasury Department. A "Partial Relief of Withholding Certificate" must be obtained and remitted to each customer. Corporations with a volume of business of $1,000,000 or more that are in good standing with the Puerto Rico Treasury Department and submit financial statements accompanied by an auditor's report may obtain a "Total Waiver of Withholding Certificate" which provides a total exemption from the 7% income tax withholding to corporations.

Fixed and Determinable Annual or Periodic Income

A withholding of income tax at source is required to be made on payments of interest, rent, salaries, wages, participation in partnership profits, commissions, premiums, annuities, remuneration, compensation, dividends, or other fixed or determinable, annual or periodical gains, profits and income (but only to the extend said items constitute gross income from sources within Puerto Rico) to non-resident individuals, or non-resident fiduciaries, or foreign corporations and foreign partnerships not engaged in trade or business within Puerto Rico. The company would be required to withhold and deduct a tax at the following rates:

Type of withholding	Tax Rate
Non-resident individuals citizens of the US (except dividends)	20%
Non-resident alien individuals (non-US citizen) (except on dividends and interest paid to a related person)	29%
Non-resident fiduciary	29%
As a General Rule, foreign corporations and partnerships not engaged in trade or business within Puerto Rico (except on dividends and interest, among others, paid to related persons)	29%
Estimated tax payment of the income attributable to a partner of partnership	30%
Estimated tax payment of the income attributable to an LLC	30%
Dividend payments to foreign corporations not in trade or business within Puerto Rico	10%
Sales of property by non-resident aliens	25%

Foreign income

To mitigate or eliminate the risk of double taxation of the same income, Puerto Rico corporations have the option of either deducting or crediting the income and excess profit taxes paid or accrued during the taxable year to the USA, any possession of the USA, or any foreign country. However, a Puerto Rico corporation may not, in the same taxable year, take a deduction for some of the non-Puerto Rico income tax paid and take a credit for the other non-Puerto Rico income tax paid.

When non-Puerto Rico income tax is credited, it is treated as a payment of Puerto Rico income tax except that it may not give rise to a refund. No foreign tax credit is allowed to reduce the accumulated earnings penalty tax.

The amount of the foreign tax credit is subject to the per-country limitation and the overall limitation.

The excess US, possessions, and foreign taxes paid or accrued by the Puerto Rico corporation over the foreign tax credit actually allowed in a taxable year may not be carried back or forward for use in other taxable years.

In addition to the foreign income and excess profits taxes paid or accrued, a Puerto Rico corporation may be deemed to have paid the foreign income and excess profits tax allocable to the distributed earnings received from its foreign subsidiary.

Individuals

Puerto Rico residents are subject to income tax on their worldwide income, while non- residents are subject to Puerto Rico tax on their Puerto Rico source income. Thus, the determination of residency is of utmost importance.

For Puerto Rico tax residence purposes, anyone who is present in Puerto Rico for a period of 183 days or more within a taxable year could be considered a resident. In addition to the number of days spent in Puerto Rico, other facts and circumstances are considered when determining whether an expatriate is considered a resident or not. A very important aspect to consider is the intention of the taxpayer as to the length and nature of their stay.

For US purposes, pursuant to Section 937 of the Internal Revenue Code, an individual must meet the following criteria to be considered a bona fide PR resident:

- be present in Puerto Rico for at least 183 days during the taxable year;
- not have a tax home outside of Puerto Rico; and
- must not show closer connections to the US or any other foreign country than to Puerto Rico.

In making the assessment of whether a particular individual is a bona fide resident of Puerto Rico, all facts and circumstances are considered. A very important aspect to consider is the intention of the taxpayer as to the length and nature of his/her stay.

Taxation of Puerto Rico residents

For 2015, the ordinary taxable income of individuals residing in Puerto Rico is taxed at progressive rates ranging from 0% to 33%. Other types of income are taxed at the following rates:

- long term capital gains - the applicable tax rate on net long-term capital gains is 15%. Capital gains and losses are long-term if the capital asset was held for more than six months prior to the realization of the gain or loss.
- certain dividends and partnership's distributions - dividends and partnership profit distributions received by an individual from a Puerto Rico corporation are subject to a 15% special tax.
- interest on certain obligations or deposits with banking organizations - interest from deposits in interest-bearing accounts or in certificates of deposits of individuals, estates, and trusts in banking institutions may be subject to a special 17% or 10% tax, in lieu of regular tax (above), at the option of the taxpayer.

If the individual's net taxable income exceeds $500,000, the benefit of the tiered rates is gradually eliminated (known as "gradual adjustment"). This net taxable income level at which the gradual adjustment applies has been increased by the 2011 Code for each taxable year.

There is also an alternative basic tax ("ABT") that may be applicable instead of the income tax determined in the manner described above. The alternative basic tax rates for taxable years commenced after December 31st, 2013 are:

- 10% if the net taxable income subject to ABT is $150,000 or more but not in excess of $200,000;
- 15% if the net taxable income is more than $200,000 but not in excess of $300,000; and
- 24% if the net taxable income is more than $300,000.

The ABT on individuals includes most "exempt income" as income for ABT purposes (including income exempted by special statute). Limited exceptions include interest on obligations of the federal government, or Puerto Rico or any instrumentality or political subdivision thereof. Also, the itemized deduction for interest on debt secured by the taxpayer's principal residence or a second home is limited to 30% of the taxpayer's adjusted gross income for purposes of the ABT computation.

Taxation of non-residents

Non-resident US citizens

A US citizen that is not a resident of Puerto Rico but receives income from sources within Puerto Rico in the amount of $5,000 or more, is required to file a Puerto Rico income tax return unless the income tax on the income has been paid entirely by way of withholding.

In determining taxable income subject to Puerto Rico income tax, US citizens not residing in Puerto Rico may only take deductions that are properly allocable to such income.

Non-resident aliens

Non-resident aliens are subject to a 29% Puerto Rico income tax rate on gross income from interest, royalties, salaries, wages, annuities, compensation, remuneration, emoluments, and other fixed or determinable, annual or periodic income; on the distributive share of the income of a special partnership; and on net capital gains from sources within Puerto Rico. Dividend income from sources within Puerto Rico is generally subject to a 15% income tax rate. The distributable share of the income from a corporation of individuals is subject to a 33% income tax rate.

A non-resident alien may deduct losses not connected to a trade or business, but incurred in a transaction entered into for profit, but only if the profit from such a transaction would have been taxable.

Non-resident aliens that receive income from sources within Puerto Rico are required to file Puerto Rico income tax returns unless the tax was paid entirely by way of withholding. Non-resident aliens that are engaged in trade or business in Puerto Rico at any time during the taxable year are subject to Puerto Rico income tax at regular rates on their net income that is effectively connected to such trade or business in Puerto Rico. In determining the net income of a non-resident alien, deductions will be allowed to the extent that they are effectively connected with the conduct of a trade or business in Puerto Rico. The due date for the filing of such returns is the fifteenth day of the sixth month following the close of the taxable year.

Special rules for expatriates

Expatriates taking up employment in Puerto Rico will be subject to comprehensive tax and employment visa requirements. US immigration rules apply in the island. Before visiting or working in Puerto Rico, foreign nationals must obtain visas from a US embassy or consulate.

Tax returns and compliance

Personal tax returns should be filed by April 15, following the end of the tax year concerned. Various extensions to file are available. Even when the required amount is withheld by the employer and deposited with Puerto Rico Treasury Department, the taxpayer has the right to file a Puerto Rico individual income tax return to claim applicable exemptions, deductions and to pay tax according to the progressive tax tables applicable to resident individuals.

The following taxpayers are required to file a Puerto Rico income tax return:

- every individual resident of Puerto Rico, who during the taxable year has a gross income over $5,000;
- every individual non-resident of Puerto Rico, citizen of the USA, who during the taxable year has a gross income over $5,000 unless the taxes have been totally paid at source;
- every non-resident alien who has a gross income from sources within Puerto Rico, unless the taxes have been totally paid at source.

Tax year

Puerto Rico's tax year for individuals typically runs from January to December.

Income from employment

Non-residents will be subject to Puerto Rico tax on employment income derived from services rendered in Puerto Rico. Some exceptions apply, depending on the amount of income generated in Puerto Rico and the time spent in Puerto Rico. Assessable employment income includes all wages, salaries, overtime pay, bonuses, gratuities, perquisites, benefits etc. that constitutes compensation for services.

There is also a requirement for the individual's employer to withhold Puerto Rico income tax from the assessable employment income. The applicable rates will depend on the expatriate's residence status. In the case of a non-resident US citizen the required withholding is 20% of the individual's Puerto Rico income, while in the case of an alien, the required withholding is 29% of the individual's Puerto Rico income.

Deductions against income

Puerto Rico residents are allowed certain deductions. Since Puerto Rico law cannot discriminate, non-resident US citizens are allowed the same deductions determined using the proportion of their PR income over their total income.

A non-resident alien is allowed only deductions directly related to the income generated in Puerto Rico. The individual would not be allowed any other deductions or personal or dependent exemptions. The advantage of filing a tax return for non- resident alien providing services in Puerto Rico is that the individual would be considered as engaged in business in Puerto Rico and as such will be able to use the graduated tax rates instead of being subject to a flat 29%.

Estimated tax payments

In particular instances, an individual will be subject to estimated tax payments. The due date for the payment of the first installment of estimated tax shall be the fifteenth day of the fourth month of the taxable year. In the case, the estimated tax shall be paid in four (4) equal installments. The second installment shall be paid on the fifteenth day of the sixth month of the taxable year, the third installment shall be paid on the fifteenth day of the ninth month of the taxable year, and the fourth installment shall be paid on the fifteenth day of the first month of the succeeding taxable year.

Other Taxes

Sales and Use Tax

Every merchant engaged in any business that sells taxable items or provides taxable services is responsible to collect the SUT as a withholding agent. Nonetheless, services rendered by Merchants with Business Volume not exceeding $50,000 annually, including those who perform designated professional services, are exempt from both the regular SUT and the 4% Special SUT.

Rates

The SUT rate is 11.5%, and in general will apply to the following items:

1. taxable services (including taxable services provided by a non-resident person to a person in Puerto Rico);
2. tangible personal property (including installation by a third party and repair)
3. admission rights
4. Combined transactions

A new SUT rate of 4%, will apply to certain services rendered from October 1, 2015. These services are:

1. designated professional services
2. business to business services

Returns

Every merchant must file a monthly Sales and Use Tax Return. An additional monthly SUT return must be filed exclusively by a merchant engaged in providing designated professional services and/or business to business services and by a merchant who received those services from a non-resident person.

These returns must be filed on or before the 20th day of the following month in which the tax is collected. The SUT return must be filed by electronic means and there is no extension available to file the returns.

For Reseller Merchants, the credit allowed to be claimed in the SUT return is 100% of the tax liability shown on the SUT return.

Every merchant engaged in trade or business in Puerto Rico that renders services that are exempt from the SUT, as well as every merchant that has a right to an exemption from the payment of the SUT, must evidence the exempt nature of the transaction by completing Form SC 2916.

Property taxes

All personal property is subject to a tax that ranges from 5.80% to 9.83% depending on the municipality in which it is located at the assessment date: January 1. Both the return and payment is due on or before May 15 of every year and must be filed with the Municipal Revenue Collection Center (the "CRIM" for its acronym in Spanish). A 90-day extension to file the personal property tax return is available for all taxpayers, provided the rules and regulations established by the CRIM are complied with.

In addition, every taxpayer subject to personal property taxes must pay an estimated tax for the taxable year in question, on the following dates: August 15, November 15, February 15 and May 15.

There is also the imposition of a real property tax for which no return needs to be filed. The CRIM issues the biannual receipts once the property is assessed. Tax rates range from 7.80% to 10.83%.

Municipal License Tax

The municipal license tax is imposed on gross income. The tax rate varies depending on the municipality but ranges from 0.2% to 0.5% in the case of non-financial businesses. For financial business the tax rate ranges from 1% to 1.50%. This tax is paid directly to the municipality.

The municipal license tax annual return or declaration must be filed every year on or before April 15, or within five working days after April 15. The municipal license tax may also be paid in two equal installments, with the first installment payable on or before July 15, while the second installment is due on or before January 15. Nonetheless, if the total municipal license tax is paid by April 15, a 5% discount will be applied.

Estate Tax/Inheritance Tax

A liability for estate and gift depends on the individual's Puerto Rico tax residence and domicile position. Non-residents will be subject to Puerto Rico estate and gift taxes only upon the transfer of Puerto Rico property.

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