



Audit



Tax



Advisory



Outsourcing

Puerto Rico tax and incentives guide 2020

If you are planning on doing business in Puerto Rico, information on the tax framework and updates on tax incentives are essential to keep you on the right track.

Business guide



Contents

| Section | Page |
|--|-------------|
| Foreword | 5 |
| Kevane Grant Thornton | 7 |
| About Puerto Rico | 9 |
| Establishing a business in Puerto Rico | 11 |
| Puerto Rico tax system | 20 |
| Tax incentives | 38 |
| Expatriates | 52 |
| Contact details | 55 |



Foreword

Foreword

Over the past years, it has become increasingly important for us to keep the business community and prospective clients informed about the benefits of establishing, relocating or expanding businesses in Puerto Rico. Puerto Rico offers the security and stability of operating in a United States jurisdiction with an array of special tax incentives for foreign direct investment that can be found nowhere else in the world.

Although economic growth has decreased during the last years, Puerto Rico offers tax incentives packages which can prove attractive to companies from the United States and other countries. These include a fixed corporate income tax rate, one of the lowest in comparison with any United States jurisdiction, various tax exemptions and special deductions, training expenses reimbursement and preferential tax treatment for pioneer activities.

Labor and tax laws and our world-class infrastructure provide the opportunities and benefits of doing business on the island. Our skilled and highly educated workforce attracts industries as diverse as: pharmaceuticals, biologics, medical devices, aviation and aerospace, information technology, renewable energy and specialized manufacturing.

At Kevane Grant Thornton, we have gathered all relevant information to summarize the tax incentives to those interested in doing business in Puerto Rico. At printing time, the government of Puerto Rico enacted into law:

- Act No. 257 of December 10, 2018, which introduced significant amendments to the Puerto Rico Internal Revenue Code (“Puerto Rico Code”); and
- Act No. 60 of July 1, 2019, known as the Puerto Rico Incentives Code, which consolidates all outstanding tax incentives laws into one single volume; adopts conforming opportunity zone incentives for local investors; and adopts tax incentives for Priority Projects under the opportunity zones regime.

This guide includes legislation in force as of December 31, 2019. It does not cover the subject exhaustively but is intended to answer some of the most important, high level 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 tax, accounting and legal advice.



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Our clients

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About Puerto Rico

About Puerto Rico

Puerto Rico, officially known as the Commonwealth of Puerto Rico (in Spanish, Estado Libre Asociado de Puerto Rico), is a self-governing, unincorporated territory of the United States, located in the northeastern Caribbean, east of the Dominican Republic and west of both, the United States Virgin Islands and the British Virgin Islands.

Government

The government of Puerto Rico has three branches: executive, legislative and judicial. The Chief of State is the President of the United States of America, and the Head of Government is a Governor democratically elected every four years, who exercises Executive Power and leads a cabinet conformed by the heads of the Commonwealth's executive departments. There are two legislative chambers: the House of Representatives and the Senate.

The judicial system is comprised by four main bodies: the Supreme Court, the Court of Appeals, the Court of First Instance and a lower-level system of municipal courts throughout the island.

Puerto Rico has authority over its internal affairs unless United States law is involved. The major differences between Puerto Rico and the 50 states are exemptions from some aspects of the United States Internal Revenue Code, its lack of voting representation in the Congress of the United States, and the ineligibility of the people of Puerto Rico to vote in the presidential elections.

The island is divided into 78 municipalities with various degrees of autonomy from the central government. San Juan is the capital and most populous municipality; together with other nine municipalities form the metropolitan area. Among the 78 municipalities, 4 are considered major cities.

The official languages of the executive branch of the government of Puerto Rico are Spanish and English. Although Spanish is spoken more commonly, business is frequently conducted in English. Spanish is the dominant language of education and daily life on the island, spoken by over 95% of the population. Public school instruction in Puerto Rico is conducted entirely in Spanish. All federal matters are conducted in English.



Population

According to the 2010 U.S Census of Puerto Rico the revised population estimate is approximately 3.5 million people. When compared to the 2000 Census, Puerto Rico has experienced a decrease in population, mainly due to a reduction in births, an increase in death rates and migration to the United States mainland.

Labor force

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.



Establishing a business in Puerto Rico

Establishing a business in Puerto Rico

Once a group of investors, or an entity, decide to do business in Puerto Rico, its management must decide which type of entity will better serve their purposes. Puerto Rico corporate and tax laws allow several options.

Sole proprietorships

A sole proprietorship is a business owned by an 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, including obtaining an Employer Identification Number for those sole proprietorships with employees other than the owner, and registering with the Registry of Businesses at the Puerto Rico Department of Treasury. 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 shield to its owner and generally terminates upon the death of its owner. Likewise, it is not taxed separately, and all income and expenses are passed through to the owner. The owner is taxed at the applicable individual rate.

A sole proprietorship may operate under a trade name (i.e. “doing business as” or “dba”). Trade names may be recorded at the Trade Name Registry for additional protection.

Partnerships

Under the provisions of the Puerto Rico Code, partnerships are pass-through entities. Rules similar to those applying to partnerships under the United States Code 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 Code partnership. Nevertheless, for a Civil Code partnership to acquire real property in Puerto Rico, it must be created through a Public Deed. The partnership does not need to register with any governmental 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 Code partnership will not dissolve upon the withdrawal of a partner if the duration of the partnership is fixed and has not expired.

The partners have a subsidiary obligation with respect to the debts of the partnership. The creditors of the partnership must first try to collect from the funds of the partnership, and 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 Code 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 a partnership under the Civil Code, but a Commercial Code partnership must meet certain formal requirements, including being executed in a Public Deed 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 Code 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 partnership's liabilities.

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. However, a limited partnership cannot include the name of a limited partner; if it does, the limited partner may be held jointly liable with the managing partners for the liabilities of the partnership.

Limited liability partnerships (LLPs)

Two or more natural persons, including those rendering professional services, can form a limited liability partnership in Puerto Rico. The limited liability partnership must register with the Puerto Rico Department of State by filing a certified copy of the constituent Public Deed accompanied by a \$110 registration fee. Registration is valid for one year and must be renewed annually by filing a renewal application for \$110. The name of the partnership must include the words "limited liability partnership" ("sociedad de responsabilidad limitada" in Spanish), or "LLP", "L.L.P.", "SRL" 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 or she had no prior knowledge of such acts.

However, a 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 corporation that met certain requirements may have elected to be treated as a special partnership for income tax purposes. This treatment allowed for a pass-through of income and losses to the owners of the entity, eliminating the double taxation applicable to regular corporations. To qualify, at least 70% of the gross income of the entity must have been from Puerto Rico sources and 70% 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 in effect.

Domestic corporations

Puerto Rico's General Corporations Act is based on Delaware's law. 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.

A typical corporate structure consists of three main groups: directors, officers, and shareholders. In the most basic terms, the corporation is owned by its shareholders, the shareholders choose the directors, and the directors are charged with overseeing the management of the corporation, which is handled by the officers. Directors must carry out their duties in good faith and without conflicts of interest; officers must perform their obligations reasonably and in good faith. The liability of directors and officers may be indemnified by the corporation. The liability of shareholders for the acts of the corporation, except in certain cases, is limited to their investment in its stock.

Any natural person or juridical entity can form a corporation by filing articles of incorporation - signed by the incorporator(s) with the proposed corporation's name, street address, business purpose (which can be stated as "any legitimate matter for which a corporation may be created"), incorporators' name and authorization, stock information, and directors' names and address - with the Corporate Division of the Department of State, along with a \$150 filing fee. De facto corporations are not contemplated under the Puerto Rico General Corporations Act. If shares have been issued, the articles of incorporations can be amended by the board of directors with shareholder approval. If no shares have been issued, the articles of incorporation can be amended by the directors (if they have been named) or the incorporators (if the directors have not been named).

The management of a corporation is typically carried out pursuant to its bylaws, which may be adopted or amended at incorporation by the incorporator(s) or thereafter by the stockholders or, if permitted by the articles of incorporation, by the directors.

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

Ownership of a corporation is altered through ownership of the corporation's capital stock, which may be issued in various classes with various rights and restrictions. Shares of corporate stock are personal property. Shareholders typically must hold meetings at least once per year. The law identifies certain corporate actions, and the articles of incorporation may specify others, that must be approved by the shareholders. Nonresidents of Puerto Rico and noncitizens of the United States may own stock and serve as directors and officers of a Puerto Rico corporation.

Corporations must file an annual report on or before April 15. Annual reports must be filed electronically, and in the case of a Puerto Rico corporation whose 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 ("CPA") licensed in Puerto Rico who cannot be a stockholder or employee of the corporation. Each annual report must be accompanied by a filing fee of \$150.

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 corporations

All corporations that are not organized under the laws of Puerto Rico are considered foreign corporations. Prior to conducting business in Puerto Rico, foreign corporations must register with the Puerto Rico Department of State, which will usually allow a foreign corporation to do business in Puerto Rico, so long as the proposed business is permitted and no other corporation is doing business under the same name.

A foreign corporation that fails to register to do business in Puerto Rico will not be allowed to initiate judicial proceedings in Puerto Rico until it is registered.

The fees required by the Department of State 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 juridical person residing in Puerto Rico, but cannot be a stockholder, officer or director of the corporation.

Professional service corporations (PSCs)

A PSC 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 PSC 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 PSC 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 PSC is not liable for the individual debts of its shareholders. Likewise, shareholders of the PSC are not liable for the liabilities of the PSC that are not related to negligent acts in the rendering of professional services.

The annual report of a PSC 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 PSCs.

Close corporations

Close corporations provide structural flexibility to corporations owned by a relatively small number of shareholders that do not intend to go public within a short period of time. To qualify as a close corporation, the certificate of incorporation must include, among other clauses, provisions stating that:

- the number of shareholders does not exceed 75 persons; and all of the issued stock of all classes is subject to one or more of the following restrictions regarding the transfer of shares:
 - a right of first refusal;
 - an obligation on the part of the corporation, any shareholder or any third party to purchase the shares subject to a purchase-sale agreement;
 - the requirement of the consent of the corporation or the shareholder of any kind of restricted security, prior to the transfer of such security; and
 - the prohibition, for a reasonable purpose, on transferring the securities to designated persons or classes of persons.

In addition, the corporation shall not make any public offering that qualifies as such under the United States Federal Securities Act of 1933.

Not-for-profit organizations

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

Instead of shareholders, a not-for-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 not-for-profit corporation similar to that of a director in a regular corporation. Also, the members of a not-for-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.

Not-for-profit corporations are required to file their annual report with the Corporation Division of the Puerto Rico Department of State, but they only pay \$5 filing fee. In the case of religious, fraternal, charitable, or educational corporations, no filing fee is required.

Corporation of individuals

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. Namely, that at least 90% of the gross income is derived from an active trade or business in Puerto Rico, though not all business activities qualify. The term domestic corporation or partnership includes for these purposes, a United States entity which is solely engaged in a trade or business in Puerto Rico. Like special partnerships and partnerships (discussed above), a corporation of individuals allows the pass-through of income and losses to the owners, thus eliminating the double taxation of income.

Limited liability companies (LLCs)

For income tax purposes, LLCs will be taxed in the same manner as corporations. Nevertheless, LLCs may elect to be treated as partnerships by choosing to be treated as such on the income tax return filing for the year the LLC is electing to be treated as a partnership. However, if an LLC organized under the laws of the United States or other foreign country is treated as a pass-through or disregarded entity for United States or other foreign country income tax purposes, it must be treated as a pass-through entity for Puerto Rico income tax purposes. This exception does not apply to those LLCs that were operating under a tax exemption grant as of the date of effectiveness of the Puerto Rico Code (i.e. January 1, 2011).

Business 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 or she may dispose of it as directed by the party who transfers the property, named constituent, for his or her 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.

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.

Cooperatives

A cooperative is a not-for-profit entity founded by a group of private persons with a common social interest. The cooperative will embody the members' solidarity and efforts to carry out socioeconomic activities to fulfill individual and collective needs. Generally, cooperatives must be formed by a minimum of eight persons (except workers cooperatives which need only five) domiciled in Puerto Rico. They are formed by filing articles of incorporation, bylaws, a feasibility study, and a revenue voucher with the Cooperative Development Administration of Puerto Rico.

If all requirements for the formation of a cooperative are met, the documentation may be submitted to the Department of State for registration. The cooperative is duly constituted when the Department of State registers the articles of incorporation and issues the corresponding certificate of registration.

A cooperative is managed by a board of directors, composed of no less than 3 and no more than 11 individuals.

Examples of the many types of cooperatives include: youth cooperatives, labor cooperatives, housing cooperatives, production credit cooperatives, consumer cooperatives, farm machinery cooperatives, and savings and credit cooperative unions. Some types of cooperatives have their own special requirements.

International financial entities (IFE)

The concept of IFEs was originally introduced in Puerto Rico by Act No. 52 of 1989. International banking entities (“IBEs”), as these entities were known then, received a different tax treatment than the one afforded to IFEs. IBEs, contrary to IFEs, were entitled to certain tax benefits by operation of law, which could be repealed or modified at any time by the Puerto Rico legislature, inasmuch as there was no contractual protection pursuant to a tax exemption grant in the nature of a contract between the government of Puerto Rico and the IBE.

The primary purpose of IFEs is to attract United States and foreign investors to Puerto Rico. Also, contrary to other financial institutions, IFEs are also allowed to enter into transactions with the Puerto Rico Government Development Bank, the Puerto Rico Economic Development Bank, the government of Puerto Rico, and deposit funds in Puerto Rico banks, participate in local loan syndications and purchase sub-standards or non-performing loans from Puerto Rico entities. Consequently, Act 273-2012 authorized IFEs to engage in traditional banking and financial transactions, principally with nonresidents of Puerto Rico. Furthermore, the scope of eligible IFE activities encompasses a wider variety of transactions than those previously authorized to IBEs. An existing IBE can continue operating under Act 52-1989, or it can voluntarily convert to an IFE, so that it may broaden its scope of eligible transactions and obtain a tax exemption grant.

IFE are licensed by the Puerto Rico Office of the Commissioner of Financial Institutions and authorized to conduct certain specified financial transactions.

Insurance companies

Insurance companies include any person engaged in the business of issuing insurance policy contracts, as defined in the Puerto Rico Insurance Code (“Insurance Code”). The Insurance Code, as well as the regulations issued thereunder by the Puerto Rico Insurance Commissioner, establishes a series of requirements for an insurance company to operate in Puerto Rico, such as: (a) funds, (b) deposits, (c) capital or surplus, and (d) investment in Puerto Rico securities, among others.

Real estate investment trusts (REITs)

A REIT is a tax designation reserved for corporations 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, including warehouses; buildings purchased from the government of Puerto Rico, its agencies and instrumentalities; and hotels.

To qualify as a REIT under the Puerto Rico 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 domestic 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.

REITs need 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 United States or a state of the United States (“USREITs”) must meet the following requirements to be treated as a REIT under the Puerto Rico Code:

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

Registered investment companies

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 investment company is deemed an issuer if it meets the following requirements:

- invests in securities with a value exceeding 90% of the total balance of its assets, excluding securities of the government of the United States, 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 shareholders entitled to vote;
- does not have more than 50% of its voting securities controlled by less than two 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 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 performs any of the activities 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 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 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.

Special employee-owned corporations (SEOCs)

The SEOC is a hybrid between a regular corporation and a cooperative. SEOCs are owned and controlled by “members” who are similar to shareholders in a corporation. A SEOC:

- may have regular members, special members, and corporate members, but there are stringent limitations on the roles of special and corporate members. Only natural persons who are employed by the SEOC in an indefinite full-time or part-time work relationship, and who render their services directly, may be admitted as regular members;
- must have at least three regular members who are not related within the fourth degree of consanguinity and second degree of affinity. In addition, at least 80% of the workers of a SEOC must be regular members;
- have up to four years to meet the 80% requirement. Each regular member is entitled to have one membership certificate and one vote regardless of the amount of capital contributed by such member to the SEOC. In any matter in which the vote of regular members is required, they have the right to cast no less than 55% of the total number of votes;

- is formed by filing a certificate of incorporation with the Corporation Division of the Puerto Rico Department of State. The initial capital of a SEOC is \$1,000. A SEOC may not issue common stock or any other type of voting stock. All the voting power of an SEOC is in its members. However, an SEOC may issue preferred stock (without voting power) and bonds like a regular corporation; and
- is considered a for-profit corporation. The regular members of an SEOC are considered self-employed in relation to labor-protective legislation, except for purposes of workmen's compensation laws and the Puerto Rico Employment Security Act.

Membership certificates may not be transferred or encumbered in any way. However, if at any time a member ceases to be an employee of the SEOC or is no longer interested in being a member, he or she may request the corporation to repurchase the membership and reimburse him or her for the balance of the corresponding internal account.

Persons that may qualify as special members are:

- consumers that patronize SEOCs engaged in retail sales;
- depositors in SEOCs engaged in financial activities;
- students in SEOCs engaged in educational activities; and
- unemployed farmers in SEOCs engaged in agricultural and agroindustrial activities.





Puerto Rico tax system

Puerto Rico tax system

United States tax system

Puerto Rico individuals

Residents of Puerto Rico are subject to federal income tax on their worldwide income. However, United States Code Section 933 allows a bona fide resident of Puerto Rico to exclude Puerto Rico-source income from his or her gross income for United States tax purposes. Bona fide residents of Puerto Rico will be subject to United States income tax on income from sources outside Puerto Rico. The exclusion of gross income from Puerto Rico sources for United States income tax purposes does not apply to the salary received by a United States government employee working in Puerto Rico, who must include federal income from work done in Puerto Rico as part of their gross income for both United States and Puerto Rico income tax purposes. However, income tax paid by a United States government employee on his or her salary to the Puerto Rico Department of Treasury may be credited against their United States income tax liability, subject to certain limitations.

Puerto Rico corporations

Puerto Rico corporations are treated as foreign corporations for United States income tax purposes. Thus, Puerto Rico corporations are subject to a 30% United States income tax withholding on, among certain types of income, interest, rents, wages, premiums, annuities, compensation, remuneration, emoluments, and other fixed or determinable annual or periodical gains, profits, and income from sources within the United States. Dividends received by a Puerto Rico corporation from a United States corporation, however, and provided certain conditions are met, are subject to only a 15% United States income tax withholding instead of the 30% rate applicable to other foreign corporations.

Puerto Rico corporations are subject to regular United States tax rates on the income that is effectively connected to a trade or business in the United States.

United States corporations

United States corporations are taxable in the United States on their worldwide income. Therefore, United States corporations that derive taxable income from Puerto Rico sources must include such income as part of their gross income for determining their United States income tax liability.

If a United States corporation decides to establish its operations in Puerto Rico through a Puerto Rico subsidiary (i.e. one created under Puerto Rico law), the latter will not constitute part of the consolidated group for purposes of filing the United States income tax return, since a Puerto Rico corporation is considered a foreign corporation for United States income tax purposes.

Puerto Rico tax system

As previously noted, the Puerto Rico Code is the main body of domestic statutory tax law. It covers taxes such as income, payroll, gift, estate, sales and use, among others.

Individual income taxes

For taxable year 2019 and forward, 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 considered long-term if the capital asset is held for more than one year prior to the realization of the gain or loss.
- **certain dividends and partnership distributions** – dividends and partnership profit distributions (if the partnership is treated as a corporation for income tax purposes) received by an individual from a Puerto Rico corporation shall be subject to a 15% preferential 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 shall be subject to a preferential 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 excess will be subject to an additional 5% tax. 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 rate for taxable years starting after December 31, 2018 is:

- 1%, if the net taxable income subject to ABT is between \$25,000 and \$50,000;
- 3%, if the net taxable income subject to ABT is between \$50,000 and \$75,000;
- 5%, if the net taxable income subject to ABT is between \$75,000 and \$150,000;
- 10%, if the net taxable income subject to ABT is between \$150,000 and \$250,000; or
- 24%, if the net taxable income subject to ABT is over \$250,000.

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 government of the United States, the government of Puerto Rico, or any instrumentality or political subdivision thereof.

For taxable years beginning after December 31, 2018, an optional tax is available for self-employed individuals whose gross income is substantially received from services subject to withholding at source. The tax rates are as follows:

- 6%, for individuals with self-employed gross income of \$100,000 or less;
- 10%, for individuals with self-employed gross income in excess of \$100,000 but not over \$200,000;
- 13%, for individuals with self-employed gross income in excess of \$200,000 but not over \$300,000;
- 15%, for individuals with self-employed gross income in excess of \$300,000 but not over \$400,000;
- 17%, for individuals with self-employed gross income in excess of \$400,000 but not over \$500,000; or
- 20%, for individuals with self-employed gross income in excess of \$500,000.

To qualify for the optional tax method, self-employed individuals must comply with the following rules:

- the total gross income for the taxable year is substantially derived from the rendering of services subject to withholding at source (80%);
- all the gross income earned during the taxable year was properly included in an informative return (i.e. 480.6SP); and
- the total gross income earned was subject to withholding at source or payment of estimated taxes.

Nonresident United States citizens

A United States citizen that is not a resident of Puerto Rico but receives income from sources within Puerto Rico greater than zero, is required to file a Puerto Rico income tax return unless the tax was paid entirely by way of withholding.

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

Nonresident aliens

As a general rule, nonresident 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 nonresident 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.

Nonresident aliens that receive income from sources within Puerto Rico are required to file a Puerto Rico income tax return unless the tax was paid entirely by way of withholding. Nonresident 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 nonresident 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 return is the 15th day of the 6th month following the close of the taxable year.

Gift tax

For gifts made on or before December 31, 2017, the gift tax shall be imposed based on the fair market value of the property donated less any obligation assumed by the donee as a result of accepting the gift. There are five allowable deductions that are based on the property donated and/or on the identity of the donee and/or the donor:

- the value of gifts made by a resident of Puerto Rico of property located in Puerto Rico;
- up to a \$5,000 value of gifts made to a disabled child;
- the value of gifts for the education or training of an individual;
- the value of gifts to provide medical care to an individual; and
- the value of certain qualified charitable gifts.

The donor is the person primarily liable for the payment of the gift tax. However, the recipient may also be held personally liable up to the value of the property received as a result of such gift.

For donors residing in Puerto Rico, the gift tax is applicable to gifts of property located anywhere in the world. For donors not residing in Puerto Rico, the gift tax is only applicable with respect to gifts of property located in Puerto Rico.

The donor may exclude the first \$10,000 from the total amount of gifts made to each donee during a determined taxable year. If the property being donated is community property, each owner may use the \$10,000 exclusion. The gift tax rate is 10% of the taxable amount. The gift tax return is due on or before January 31 of the year following the year of the gift. If the donor does not file the return, the donee must file the return on or before February 28 of the year following the year of the gift.

Gifts made after December 31, 2017, are not subject to the 10% tax rate, provided they are still required to be reported on a gift tax return on the dates prescribed above. Furthermore, the basis of donated property will be the same basis the property had in the hands of the donor at the time such gift was made.

Estate tax

For estate tax purposes, the Puerto Rico Code differentiates between: (1) United States citizens who did not acquire their citizenship by being born or naturalized in Puerto Rico and were residents of Puerto Rico at the time of death, and; (2) those individuals who were nonresidents of Puerto Rico at the time of death but had certain property located in Puerto Rico. Tax will be imposed on the estate of a decedent whose date of death is on or before December 31, 2017. For taxable years after December 31, 2017, estates are not subject to tax, provided there are still required to be file an estate tax return on the dates prescribed below. After December 31, 2017, the tax basis of the inherited property will be the same basis the property had in the hands of the decedent. The discussion below applies to deaths occurring on or before December 31, 2017.

Under the Puerto Rico Civil Code, the gross estate includes all the property, rights, and obligations of the decedent that are not extinguished by death.

As a general rule, the estate of a decedent that was a resident of Puerto Rico at the time of death and before January 1, 2018, includes all the property of such decedent, wherever located. However, the estate of a nonresident alien or person who was a resident of Puerto Rico at the time of death but did not acquire the United States citizenship solely by reason of being a citizen of Puerto Rico or being born or residing in Puerto Rico, will be taxed only on the part of the estate located in Puerto Rico. In such cases, the estate tax will equal the maximum foreign estate tax credit granted under the United States Code, or other applicable foreign jurisdiction law, for the portion of the gross estate located

in Puerto Rico.

Upon the death of a decedent, an estate tax lien is automatically imposed on all the assets of the decedent. A Release of Estate Tax Lien will not be issued until the estate tax return is filed and all taxes owed by the decedent to the government of Puerto Rico (including income taxes) or to its municipalities, have been fully paid. If the outstanding taxes are prescribed, a certificate to that effect must be obtained.

The executor of an estate is the person primarily liable for the payment of the estate tax. After filing the estate tax return and paying the corresponding tax, the executor may ask the Secretary of Treasury that he or she be released from personal liability with respect to the payment of deficiencies. If the Secretary of Treasury does not reply to the request within one year after the date of filing the request, the executor is released from that liability.

The Puerto Rico Code establishes a limited number of deductions to reduce the gross estate, which depends on the property transferred or the recipient. For example, a deduction from the gross estate equal to the fair market value of property located in Puerto Rico is granted. As a result of this deduction, most estates in Puerto Rico are exempt from estate tax. Also, deductible from the gross estate are:

- the fair market value of property that passes from the testator to the surviving spouse by bequest, devise, or inheritance;
- bequests or legacies made to not-for-profit organizations; and
- if the decedent derived over 50% of his or her net income from agricultural, poultry, and animal husbandry enterprises for three years prior to his or her death, the value of all the property used in such businesses can be deducted from the gross estate.

A number of deductions are allowed based on the liabilities of the decedent or expenses of the estate. Such deductions are summarized as follows:

- outstanding debts of the decedent at the time of death;
- taxes owed by the decedent to the government of Puerto Rico at the time of death;
- the amount of the mortgage, if the mortgaged property was included in the gross estate;
- funeral expenses up to a maximum of \$6,000;
- accidental losses caused by fires, earthquakes, or hurricanes taking place within nine months following the decedent's

- death and not compensated by insurance or otherwise; and
- total fees paid to lawyers, accountants, appraisers, surveyors, partitioners, and executors actually incurred until the day of the filing of the estate tax return up to a maximum of 5% of the gross estate.

Puerto Rico residents are allowed a \$1,000,000 deduction. Such deduction shall be claimed before the deduction for property located in Puerto Rico and allocated among all the assets included in the gross estate, using as basis the fair market value thereof. A credit for the responsible taxpayer is allowed for the total amount of the tax reduced by other credits, if at the time of death, the decedent does not have debts pending payment for tax obligations and the executor complies with the payments, within the terms established by law, of the tax obligations due after the decedent's death.

The applicable estate tax rate is 10% of the taxable amount of the estate of a decedent whose date of death is on or before December 31, 2017.

The estate tax return of a decedent who died before January 1, 2018, is due on or before 9 months after the decedent's death. The estate tax return of a decedent who died after December 31, 2017, is due on or before 12 months after the decedent's death.

Business taxes

Sole proprietorships

A sole proprietorship is taxed on the net income from the operation of its trade or business. The net income, generally, is determined using the rules discussed below for corporations. However, the Puerto Rico Code establishes a series of exceptions, such as the treatment of the net operating losses. Specifically, net operating losses incurred by a business operated by an individual as a sole proprietorship may not be used to reduce the net income derived from other business activities conducted by the same individual. However, if married individuals filing jointly, each owning a different principal trade or business, both principal trades and businesses will be treated as one principal trade or business for purposes of the net operating loss deduction.

Partnerships

Upon the enactment of the Puerto Rico Code in 2011, partnerships and joint ventures, among others, are now provided pass-through tax treatment for income tax purposes. The tax

treatment of partnerships and their partners is similar, but not identical to the treatment under the United States Code.

Instead of being taxed at the partnership level, these entities are taxed at the partner level. Partners' fiscal responsibility is based in their distributable share of the partnership's income items, at their applicable rate, even though the income was not distributed. Moreover, partners are deemed engaged in trade or business in Puerto Rico with respect to their distributive share in the partnership.

Nonetheless, partnerships existing as of January 1, 2011, may elect to continue being treated as a corporation. In such case, partnerships and their partners are subject to tax at the partnership level and again at the partner level to the extent the partnership makes any distributions.

Limited liability companies

LLCs are generally taxed as corporations, being subject to tax at the entity and member levels. Nevertheless, LLCs may elect to be treated as partnerships for income tax purposes, receiving pass-through tax treatment under the partnership rules of the Puerto Rico Code, thus being taxed at the member's level on their respective distributable share of the LLCs' income items.

Special partnerships

A partnership or a corporation that meets certain requirements may have elected to be treated as a special partnership for income tax purposes. This treatment allows for 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 must be derived from sources within Puerto Rico and 70% of the gross income 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, 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.

Corporations of individuals

Domestic corporations and partnerships owned by 75 or less individuals may elect to be treated as a corporation of individuals for income tax purposes if 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 United States entity which is solely engaged in a trade or business in Puerto Rico.

Like special partnerships, a corporation of individuals allows the pass-through of income and losses to the owners, eliminating the double taxation of income.

Corporations

For income tax purposes, corporations (including entities taxed as corporations) and business trusts, among others, are treated the same; there is no pass-through of income or losses to the shareholders of such business entities, instead, taxes are levied at the corporate level and again at the shareholder level when actual distributions are made. Before the enactment of the Puerto Rico Code in 2011, partnerships were taxed as corporations. Therefore, any reference to corporations in this section may also include the partnerships taxed as such.

A domestic corporation (i.e. one organized under the laws of Puerto Rico) is taxed on its worldwide income. If tax is paid to a foreign jurisdiction, a foreign tax credit or deduction may be claimed, subject to certain limitations.

As previously mentioned, a corporation incorporated under the laws of Puerto Rico is considered a foreign corporation for United States income tax purposes. Therefore, a United States corporation operating in Puerto Rico through a domestic subsidiary will not constitute part of a consolidated group for purposes of filing a United States income tax return.

Puerto Rico corporations are taxed on their total net taxable income derived from any source whatsoever. Basically, the tax is determined by:

- excluding of certain items from gross income;
- excluding the items of income that are taxed at a different or preferential rate;
- reducing the remaining amount by the corresponding deductions;
- applying the preferential tax rates to the preferential-tax-rate items to determine the tax on preferential items;

- adding the partial tax to the tax on preferential items to determine the total corporate income tax; and
- reducing the total corporate income tax by estimated taxes paid, withheld amounts, and other credits.

The result is the amount of Puerto Rico corporate income tax due.

Tax accounting period

A tax year generally consists of a period of 12 months. A taxpayer may select its tax accounting period on or before the due date for the filing of its first income tax return, without considering extensions of time to file.

The Puerto Rico Code allows for: (a) calendar year; (b) 12-month fiscal year; and (c) 52 and 53-week year tax accounting periods.

Once a taxable year is selected, that taxable year must continue until the Puerto Rico Department of Treasury approves a change or the law specifically permits otherwise.

Tax accounting methods

In general, the accounting method used by a taxpayer to determine its net income for regular business purposes must be used to determine net taxable income for tax purposes. However, the accounting method used for tax purposes must be one that clearly reflects income and expenses. The following accounting methods are allowed for Puerto Rico income tax purposes:

- cash receipt and disbursement;
- accrual;
- any other method permitted by the Puerto Rico Code;
- any combination of the methods permitted;
- percentage of completion; and
- completed contract.

Inventories

The method of inventory used for tax purposes must conform to the best accounting practices in the corresponding trade or business. The term “best accounting practices,” as used in the Puerto Rico Code, are generally the same as “generally

accepted accounting principles”. In certain cases, however, generally accepted accounting principles may conflict with the clear reflection of income requirement; if such conflict occurs, the clear reflection of income should prevail. The most common methods that may be used to identify inventory are: (a) specific identification method; (b) first-in, first-out method (FIFO); (c) last-in, first-out method (LIFO); and (d) weighted-average cost method.

Pursuant to the Puerto Rico Code, inventories must be valued at the lower of cost or market value. The current regulations (regulations under the Puerto Rico Code of 2011 have not been issued yet), offer a number of rules regarding the use of the accounting methods and the valuation of inventories of certain businesses such as securities, farming, livestock breeding, mining and manufacturing, and retailing.

Reserve method

The reserve method for deductions of bad debts is not allowed under the Puerto Rico Code.

Gross income

The meaning of gross income is broad and general. The Puerto Rico Code provides that gross income includes gains, profits, and income derived from salaries, wages, or compensation for personal services, interest, rent, dividends, benefits from debt forgiveness, partnership profits, securities, or the transaction of any business carried on for gain or profit, or gains or profit and income derived from any source whatsoever.

By the same token, the Puerto Rico Code includes several exemptions and exclusions from gross income. Some of these are:

- interest from obligations issued by the United States and any of its states, territories, possessions, Puerto Rico, or political subdivisions thereof; and
- dividends from industrial development income that consists of interest derived from obligations of the government of Puerto Rico or its instrumentalities or political subdivisions.

Capital gains

Under the Puerto Rico Code, corporations may elect to have gains that are derived from the sale or exchange of a capital asset: (i) taxed at a preferential income tax rate and have their other income taxed in the regular manner, or (ii) included as part of their gross income and taxed at the corresponding ordinary income tax rate. If the first method is chosen, all long-term capital

gains and losses are excluded from the gross income that is taxed at the regular tax rates. The alternate capital gains tax rate for corporations is 20%. A capital gain or loss is long-term if the capital asset was held by the transferor for more than one year prior to the transfer.

Notwithstanding the above, the following do not qualify as capital assets:

- stock in trade of the taxpayer or other inventory-type property and property held primarily for sale to customers in the ordinary course of a trade or business;
- property used in a trade or business entitled to depreciation and real property used in a trade or business;
- copyrights to literary property, musical, or artistic composition, a letter or memorandum or similar property in the hands of the creator or the transferee that takes the basis of the creator; and
- accounts payable or promissory notes acquired in the ordinary course of business.

There are several other situations in which the requirement of a sale or exchange for capital gain treatment is missing, but a capital gain or loss nevertheless will result because a statute creates a deemed sale or exchange or a deemed capital gain or loss. Examples of those situations are: securities becoming worthless; retirement of bonds and other securities issued by corporations, partnerships, a government and political subdivisions thereof, with interest coupons or in registered form; gains or losses attributable to the failure to exercise privileges or options to buy or sell property; distributions in excess of earnings and profits and of the basis of the stock; and distributions in liquidations or in partial liquidations.

Nonrecognition transactions

There are certain transactions in which a realized gain is not recognized for tax purposes and, therefore, is excluded from gross income. In general, the reason for not recognizing such gains is that the underlying transaction is not considered sufficient to break the continuity of the investment. Examples of these transactions are tax-free reorganizations.

Source of income rules

Personal services

Compensation paid for personal services performed in Puerto Rico.

Interest income

The source of interest income is generally determined by reference to the residence of the debtor. The Puerto Rico Code grants preferential tax treatment to certain types of interest, such as interest on government bonds and interest on deposits in Puerto Rico financial institutions.

Dividend income

A Puerto Rico corporation's dividend distributions are subject to a 15% withholding tax upon distribution (see sourcing rules above).

An accumulated earnings penalty tax of 50% may be imposed if a corporation is determined to have been formed or used to prevent the imposition of income tax on its shareholders by accumulating corporate earnings instead of distributing such earnings to the shareholders. If the earnings have been accumulated because the reasonable needs of the business so dictate, the accumulated earnings penalty tax may not be imposed. When determining the amount of the accumulated earnings penalty tax, the accumulated earnings covered under a tax exemption grant of industrial, tourist and other similar laws are not taken into consideration.

Rents and royalties

Income from rents and royalties paid with respect to property located in Puerto Rico, and rents and royalties paid for the use of, or for the privilege of using, within Puerto Rico, intangible assets such as patents, copyrights, trade secrets, formulas, goodwill, trademarks, trade names, and franchises, are treated as derived from sources within Puerto Rico. Also treated as income derived from sources within Puerto Rico are payments made for the right to transmit, within Puerto Rico, television and radio programs, films, and other similar property.

Sale of real property

Gain from the sale of real property is sourced where the real property is located.

Sale of personal property

The source of income from the sale of personal property is determined by the seller's residence.

Sale of inventory

Gain from the sale of inventory property produced, in whole or part, by the taxpayer within Puerto Rico and sold outside Puerto Rico or produced, in whole or in part, by the taxpayer outside

Puerto Rico and sold within Puerto Rico is treated as derived partly from sources within and partly from sources without Puerto Rico.

Gains derived from the sale within Puerto Rico of personal property purchased by the taxpayer outside Puerto Rico and from the sale of personal property purchased within Puerto Rico by the taxpayer and sold outside Puerto Rico is treated as derived entirely from sources within the country in which it was sold. If the personal property is produced and sold in Puerto Rico, the income from the sale will be sourced in Puerto Rico.

Distribution from liquidation of a Puerto Rico corporation

Income derived from the total or partial liquidation of a Puerto Rico corporation or partnership is treated as derived from sources within Puerto Rico.

Distribution from the liquidation of a foreign corporation

Income derived from the partial or complete liquidation of a foreign corporation or partnership is treated as derived from sources within Puerto Rico, if 80% or more of the corporation's or partnership's gross income for the three years preceding the liquidating distribution was effectively connected with the conduct of a trade or business in Puerto Rico. However, the income will be treated as from sources within Puerto Rico only in an amount that bears the same ratio to the total amount of the liquidating distribution as the gross income of the corporation or partnership effectively connected to the trade or business in Puerto Rico (excluding income considered in determining the branch profit tax, if applicable) bears to gross income from all sources.



Insurance premiums

Premiums paid with respect to a contract insuring risks located in Puerto Rico are treated as income derived from sources within Puerto Rico. However, premiums paid on life insurance contracts to a person not engaged in trade or business in Puerto Rico is not treated as income derived from sources within Puerto Rico.

Business expenses

In general, the rules for the deductibility of the business expenses of a corporation or partnership closely follow the applicable rules under the United States Code. Therefore, expenses incurred by a corporation or partnership during the taxable year that are directly connected to its business activities are generally deductible.

There are certain items which are statutorily nondeductible even though they would otherwise qualify as a business expense.

Organizational expenses

Organizational expenditures are deductible only when the corporation or partnership is dissolved. When a corporation or partnership charter or certificate is issued for a limited time only, the expenses can be amortized over that period.

These nondeductible expenditures are generally incidental to the creation of the corporation or partnership, such as legal fees for drafting the corporate or partnership charter, bylaws, minutes of organizational meetings, and original stock certificates, fees for start-up accounting services, expenses of temporary directors and organizational meetings of directors or stockholders, operating agreements, and state incorporating fees.

Organizational expenses also relate to those incurred for issuing or selling shares of stock or other securities, such as commissions, professional fees, and printing costs, as well as to the transfer of assets to a corporation or partnership or the reorganization of a corporation or partnership.

Travel and meals and entertainment expenses

An employer may deduct the paid or reimbursed travel expenses incurred by its employees while working away from home, provided such expenses are ordinary, necessary, and reasonable. These expenses generally include transportation, meals, and lodging expenses for business-related travel. Meals and entertainment expenses are subject to 50% and 25% limitation rules, in addition to being limited by the requirements of these being ordinary, necessary and reasonable. The 50% limitation rule provides that only 50% of the total of such expenses are

allowed as a deduction. The 25% limitation rule requires that the total of such deductions never exceeds 25% of the gross income of the person taking the deduction.

For taxable years starting after December 31, 2018, the 50% limitation rule is reduced to 25% of the total of the meals and entertainment expenses allowed as a deduction, provided the deduction shall never exceed 25% of the gross income of the corporation or partnership taking the deduction. Furthermore, travel expenses claimed as a deduction for taxable years commencing after December 31, 2018, are limited to 50% of the travel expenses paid or incurred during the year.

Interest

As a general rule, interests are only deductible if the taxpayer has an obligation to pay the interest and if it is an ordinary and necessary expense. However, interest related to an indebtedness incurred to purchase obligations which are exempt from Puerto Rico income taxes are nondeductible.

Royalties

Royalty payments are deductible within the category of ordinary and necessary expenses.

Retirement plan contributions

Basically, retirement plans can be divided into two types: (i) qualified plans and (ii) nonqualified plans. Qualified plans are those specifically covered by the Puerto Rico Code. These plans offer a special tax treatment to the: (i) employer, who is allowed to deduct contributions made to the plan; (ii) participants, who can defer the employer's contributions until they are actually received; and (iii) the trust that controls and administers contributions to the plan and payments of benefits to the participants, which is treated as a tax-exempt entity. Qualified plans are heavily regulated and are subject to strict reporting requirements.

Taxes

Taxes paid or accrued by persons that are not individuals are deductible unless otherwise prescribed by the Puerto Rico Code. Puerto Rico income tax and all inheritance, estate, succession, and gift taxes are specifically listed as nondeductible. Income taxes, war-profit taxes, and excess-profit taxes not imposed by Puerto Rico (i.e., imposed by the United States or any of its possessions, or by a foreign government) are deductible, but only if they are not otherwise claimed as a credit.

Federal import duties and Puerto Rico excise taxes on manufactured and imported goods are nondeductible (these charges are included as part of the costs of the goods). However, such taxes may be deductible if they qualify as necessary and ordinary business expenses. In such case, they would be deductible as a business expense and not as a tax and would therefore be required to meet the ordinary and necessary test.

Automobile license fees are considered a tax. As such, they do not need to meet the “ordinary and necessary” test.

Depreciation and depletion

The cost of business assets with a useful life of more than one year may not be deducted in full in the year of acquisition because part of the cost relates to future years. This deduction is generally referred to as depreciation. Inventory and stock in trade are not depreciable property.

The three depreciation systems that may be used under the Puerto Rico Code are:

- straight-line depreciation;
- accelerated cost recovery system (ACRS); and
- flexible depreciation as applicable to those assets for which an election was made. No new elections are allowed by the Puerto Rico Code.

Obsolescence

Generally, obsolescence is taken into consideration when determining the useful life of property. A special deduction for extraordinary obsolescence may be allowed when the economic life of the property ends prior to the termination of its normal useful life.

Charitable contributions

Corporations or partnerships may deduct charitable contributions made within the taxable year to religious, charitable, scientific, literary, or educational organizations. The amount of charitable contributions made during a year may not exceed 10% of the net income, computed without the benefit of the charitable deduction. Charitable contributions made in excess of 10% of net income may be carried over to the following five years.

Capital losses

For taxable years ending before January 1, 2015, corporations and partnerships are allowed to deduct capital losses of up

to 90% of the gains from such sale or exchange. Moreover, for taxable years beginning after December 31, 2014, the limitation is further reduced to 80%. The carryover period for capital losses incurred is 7 years. For taxable years starting after December 31, 2018, the limitation is reestablished to 90%.

Casualty losses

Casualty losses sustained by a corporation or partnership and not compensated for by insurance or otherwise are deductible. The basis for determining the amount of the loss sustained is the adjusted basis of the lost property.

Bad debts

Corporations or partnerships are entitled to an ordinary deduction for business debts that become worthless, or for the part of such debts that become worthless, during the taxable year. To allow the deduction for a bad debt, the taxpayer must have included the amount of such debt as income.

Worthless bonds and similar obligations; worthless stock and right to acquire stock

If bonds, debentures, notes, certificates of debt, and other similar evidences of indebtedness become worthless during the year, the loss is considered due to the sale or exchange of a capital asset on the last day of the taxable year. In that instance, the corporation or partnership holding the worthless securities will have a long-term or short-term capital loss depending on the length of the period during which the security was held. If the worthless security was held for more than one year, the loss will be treated as a long-term capital loss; otherwise it will be treated as a short-term capital loss. Partial worthlessness and reduction in value due to market fluctuations are not deductible.

Inventory write-downs

Goods in inventory that are unmarketable at normal prices or unusable because of damage, imperfections, shop wear, change of style, odd or broken lots, or other similar causes may be valued at their bona fide selling price less the direct cost of their disposition.

Rents

Rental payments made by a corporation or partnership are generally considered part of the business expenses of the corporation and, thus, deductible. Property taxes on leased property paid by the lessee pursuant to the terms of the lease are considered additional rent paid by the lessee. The amount of the property tax on the leased property paid by lessee is deductible by the lessor.

Salaries and wages

All reasonable salaries and wages, as well as commissions, bonuses, fees, compensation payments, and other similar payments made for services rendered paid by corporations or partnerships, are deductible as a business expense.

Capital expenditures

The Puerto Rico Code follows the United States Code with respect to capital expenditures. The concept of capital expenditures is also based on the principle that the accounting method used must clearly reflect income.

Capital expenditures, instead of being deducted in the year in which they are paid or accrued, are included as part of the basis of the acquired or improved asset. In addition, depending on the asset and the circumstances involved, such capital expenditures will be depreciated, amortized, or depleted pursuant to the applicable depreciation, amortization, or depletion rules, or included as part of the basis until the asset is sold or disposed of. Amounts paid for securing a copyright, defending or perfecting title to property, architect's services in relation to the construction of a building, and commissions in purchasing securities are capital expenditures.

Net operating loss (NOL) carryovers

For purposes of determining the amount of the net operating loss carryover, net operating loss equals 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; and
- the net operating loss deduction carry forward from previous years is not deducted. The carryover period will depend on the year the loss was originated. For losses generated after December 31, 2012, the carryover period is 10 years.

For taxable years beginning after December 31, 2014, the NOL carryforward amount is limited to 80% of net income for regular tax purposes and 70% for alternative minimum tax ("AMT") purposes (explained further on). For taxable years beginning after December 31, 2018, the NOL carryforward amount is increased to 90% of net income for regular tax purposes and remained at 70% for AMT purposes.

Nondeductible expenses

The Puerto Rico 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 Puerto Rico Code provides that 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. For taxable years beginning after December 31, 2018, the limitation may be waived if the taxpayer files with the income tax return a transfer pricing study prepared in accordance with section 482 of the United States Code, except in cases in which no related entity operates in the United States, then OECD transfer pricing guidelines may be used.

In addition, expenses incurred or paid for services rendered by a nonresident 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.



Tax credits

Foreign tax credit

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 United States, any possession of the United States, 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 United States, states, territories, possessions, or 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.

Tax rates and calculation of taxable income

Corporate income tax rates

Corporations, domestic or foreign, engaged in trade or business in Puerto Rico are subject to an income tax rate composed of two parts a:

- “normal” tax; and
- “surtax”.

Normal tax

For taxable years before January 1, 2019, the first component is calculated by multiplying normal net taxable income times the 20% fixed tax rate. The normal taxable net income is regular net taxable income less 85% (or 100%) of the dividend income received from Puerto Rico corporations. For taxable years beginning after December 31, 2018, the normal tax rate is reduced to a fixed tax rate of 18.5%.

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.

| Surtax net income bracket (\$) | Tax on lower amount (\$) | Rate on excess over lower | In excess of (\$) |
|--------------------------------|--------------------------|---------------------------|-------------------|
| 1 - 75,000 | 0 | 5% | 0 |
| 75,001 - 125,000 | 3,750 | 15% | 75,000 |
| 125,001 - 175,000 | 11,250 | 16% | 125,000 |
| 175,001 - 225,000 | 19,250 | 17% | 175,000 |
| 225,001 - 275,000 | 27,750 | 18% | 225,000 |
| 275,001 - upward | 36,750 | 19% | 275,000 |

To determine the surtax rate applicable to corporations within a controlled 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 (AMT)

The alternative minimum tax is designed to ensure that corporations with substantial economic income may not avoid paying a reasonable amount of income tax by using exclusions, deductions, and credits available to them.

For taxable years before January 1, 2019, the AMT equals the excess of the amount of the tentative minimum tax over the amount of the normal tax plus surtax. The tentative minimum tax will be 30% of the excess of the net alternative minimum income over the exempt amount, reduced by the alternative minimum foreign tax credit for the taxable year.

For taxable years beginning after December 31, 2018, new limitations are imposed regarding deductible expenses to determine the net income subject to AMT. Furthermore, there is an option to claim all the ordinary and necessary expenses if the taxpayer submits audited financial statements, agreed upon procedures (AUP) or compliance attestation reports by a CPA with license to practice in Puerto Rico.

Regarding amounts paid to related parties, the Puerto Rico 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 Puerto Rico Code provides that 51% of these expenses are not allowed as a deduction for ordinary tax computation. However, the Secretary of the Treasury may provide waivers or relief against this disallowance but this authority will be limited to 60% of the expenses.

For taxable years beginning December 31, 2018, the alternative tentative minimum tax will be the greater of \$500 or 18.5% of the alternative minimum net income. Furthermore, no adjustment or limitation shall apply in regard to 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 a transfer pricing study is submitted with the income tax return.

Optional tax

For taxable years beginning after December 31, 2018, an optional tax is available for corporations or partnerships whose gross income is substantially received from services subject to withholding at source. The tax rates are as follows:

- 6%, for gross income of \$100,000 or less;
- 10%, for gross income in excess of \$100,000 but not over \$200,000;

- 13%, for gross income in excess of \$200,000 but not over \$300,000;
- 15%, for gross income in excess of \$300,000 but not over \$400,000;
- 17%, for gross income in excess of \$400,000 but not over \$500,000; or
- 20%, for gross income in excess of \$500,000.

To qualify for the optional tax method, corporations or partnerships must comply with the following rules:

- the total gross income for the taxable year is substantially derived from the rendering of services subject to withholding at source (80%);
- all the gross income earned during the taxable year was properly included in an informative return (i.e. 480.6SP); and
- the total gross income earned was subject to withholding at source or payment of estimated taxes.

Assessment and filing

Income tax return

Corporations or entities taxed as corporations, domestic or foreign, that are engaged in trade or business in Puerto Rico are required to file an annual income tax return and pay the corresponding tax on or before the 15th day of the 4th month following the close of its taxable year. Partnerships must file on or before the 15th day of the 3rd month following the close of its taxable year.

An automatic 6-month extension of time will be granted to corporations or partnerships for the filing of the 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 accompanied by the full balance of the income tax due.

Pursuant to the Puerto Rico Code, every corporation or partnership whose volume of business is equal to or exceeds \$3,000,000 must file audited financial statements along with its income tax return. In the case of related entities, as such term is defined in section 1010.05(a) of the Puerto Rico Code, the volume of business will be determined by adding the volume of business of each of the entities included in said group. If the aggregate volume of the group is \$3,000,000 or more, then each entity within the group with a volume of business of \$1,000,000 or more must file audited financial statements with its income tax return.

Estimated tax

In addition to the 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 must be paid in four equal installments by the 15th day of the fourth, sixth, ninth, and twelfth month of the taxable year.

Consolidated returns

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

Funding the corporation

As a general rule, no income is recognized by a Puerto Rico corporation on the original issuance of its stock. The Puerto Rico Code requires that if the transferor consists of more than one person, the amount of shares and securities received by each person must be proportional to their interest in the transferred property prior to the transfer.

When a corporation assumes the liabilities of the transferor or receives property from the transferor subject to liabilities, such assumed liability is not treated as a receipt of money or other property by the transferor in determining whether the transfer is “solely in exchange of stock or securities.” However, for the purpose of determining whether the stock or securities received by the transferors are substantially proportionate to their interest in the transferred property, the assumed liabilities are treated as stock or securities received by transferors.

The basis of the stock or securities received by a transferor in a nonrecognition exchange with a Puerto Rico corporation is equal to the basis of the property transferred in exchange for the stock or securities, decreased by the amount of money received, increased by the amount of gain recognized, and decreased by the amount of loss recognized by the transferor. The liability assumed by the corporation is treated as money received by the transferor for the purpose of determining the basis of the stock or securities received by the transferor.

Reorganizations in general

In general, the reorganization rules under the Puerto Rico Code follow a pattern similar to that of the reorganization rules of the United States Code, with the principle underlying both Codes being that no gain or loss should be recognized because the new corporate structure is merely a continuation of the previous structure. The recognition of gain or loss is postponed by means of a carryover of the basis.

The Puerto Rico Code lists the same types of reorganizations as the United States Code, except the Puerto Rico Code does not list the transfer by a corporation of all or part of its assets to another corporation in a Title 11 bankruptcy filing or a receivership, foreclosure, or similar proceeding in a federal or state court. However, the Puerto Rico Code specifically provides that no gain or loss is recognized in certain exchanges made in connection with the reorganization of an insolvent corporation affected in a receivership, foreclosure, or other similar court proceeding, or in a court reorganization proceeding under Section 77B or Chapter X of the Federal Bankruptcy Code.

Liquidations

Generally, a gain or loss may be recognized upon the liquidation of a Puerto Rico corporation at both the corporate and shareholder levels. At the corporate level, liquidation will be treated as if the corporate assets are being sold to the shareholder at fair market value. At the shareholder level, the liquidation is treated as an exchange by the shareholder of its shares of stock for the assets received from the corporation. Thus, a gain or loss will be recognized based on the difference between the fair market value of the assets received and the adjusted basis of the shares of stock being surrendered.

No gain or loss is recognized upon the complete liquidation of a controlled subsidiary into its parent corporation. In this case, control is the ownership of at least 80% of the total combined voting power and at least 80% of the total number of shares of all other classes of stock. This ownership requirement must exist on the day that the liquidating plan is adopted and must continue to exist until the liquidating distribution is made. If there is only one liquidating distribution, all the property must be transferred to the parent in the same tax year. If there are a series of distributions, all the properties must be transferred to the parent within three years from the close of the taxable year during which the first distribution was made.

Acquisition of stock with step-up in basis of assets of acquired corporation

A corporate tax election is available to an acquiring corporation to step up the basis of the assets in a target corporation the stock of which it purchased.

Foreign entities doing business in Puerto Rico

A foreign corporation (one that is organized under the laws of a country other than Puerto Rico) may engage 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 same graduated tax rates as any domestic corporation.

Subsidiary

A foreign corporation that is engaged in a trade or business in Puerto Rico must treat the following as income effectively connected to its trade or business in Puerto Rico:

- all income from sources within Puerto Rico;
- income attributable to an office or other fixed place of business in Puerto Rico that consists of:
 - rents or royalties derived from the use outside Puerto Rico of intangibles such as secret processes, formula, patents, trademarks, franchises, and copyrights;
 - dividends or interest or gain or loss from the sale or exchange of stocks or bonds or other evidences of indebtedness that is either derived from a banking or financing business or from a corporation trading in stocks or securities for its own account;
 - gains or losses derived from the sale or exchange of personal property outside Puerto Rico through the corporation's office or fixed place of business in Puerto Rico (except gains or losses from the sale of personal property that is manufactured outside Puerto Rico and is to be used, consumed, or disposed of outside Puerto Rico).
- income or gain attributable to the rendering of services or the sale of property in another year if in such other year it would have been treated as effectively connected income; and
- gain or loss from the sale or disposition of property that is used in connection with a trade or business in Puerto Rico or that ceased to be used in connection with a trade or business in Puerto Rico within the previous 10 years.

The foreign subsidiary will be allowed to deduct the expenses directly allocable to the Puerto Rico business. In addition, a reasonable apportionment of expenses not directly related to any item of income shall be allowed as a deduction. Nevertheless, please bear in mind that as previously mentioned, the Puerto Rico Code allows for the disallowance of 51% percent of the expenses or charges incurred by a taxpayer, such as a subsidiary, 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. Again,

the Secretary of the Treasury may still provide a waiver against this disallowance but this authority will be limited to 60% of the expenses. If the taxpayer files a transfer pricing study together with the income tax return, including an analysis of the Puerto Rico operations, then the taxpayer will have an exemption from the 51% disallowance.

Effective for taxable years beginning after December 21, 2018, the transfer pricing study must be prepared in accordance with Section 482 of the United States Internal Revenue Code, except cases in which no related entity operates in the United States, than the OECD transfers pricing guides may be used.

Any actual repatriation of dividends are subject to a 10% income tax withholding at source, and for purposes of filing the United States income tax return, it may be included in the consolidated income tax return. 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 may be imposed.

Foreign corporations not having any office or place of business in Puerto Rico must file their Puerto Rico income tax returns on or before the 15th day of the 6th month following the close of their taxable year. However, if the Puerto Rico income tax liability of a foreign corporation was paid in full under the withholding provisions, the foreign corporation will be exempt from the filing requirement.

A foreign corporation that is not engaged in trade or business in Puerto Rico, but derives income from real property located in Puerto Rico owned for the production of income, may elect to treat such income as connected to the conduct of a trade or business in Puerto Rico, whether the income is rent or gain from the sale or exchange of the property. If it exercises the election, the foreign corporation not engaged in trade or business in Puerto Rico will be taxed on the real property net taxable income at regular Puerto Rico income tax rates instead of a 29% tax rate on the gross income from the real property. However, the election does not by itself cause any other income received by the foreign corporation not engaged in trade or business in Puerto Rico to be treated as income effectively connected to a trade or business in Puerto Rico.

Certain nonresident alien individuals or nonresident foreign entities

Source of income rule

Certain nonresident alien individuals or nonresident foreign entities may be treated as engaged in trade or business in Puerto Rico and deriving income from Puerto Rico sources for income tax purposes.

An office or a fixed place of business of a person related to the nonresident alien or nonresident foreign corporation or partnership may be treated as the office or fixed place of business of the nonresident person, being treated thereby as engaged in trade business in Puerto Rico. A Puerto Rico office of a related person is treated as an office or fixed place of business of the nonresident alien individual or nonresident foreign entity in Puerto Rico when:

- such related person had the authority to negotiate and contract in the name of the foreign taxpayer and regularly exercised that authority or maintained an inventory of merchandise from which orders in the name of the foreign taxpayer were regularly filled; and
- such nonresident alien individual or nonresident foreign entity purchases goods from a related company (more than 50% ownership) that manufactures, in whole or in part, personal property or performs services for or on behalf of, such nonresident alien individual or nonresident foreign entity in Puerto Rico, which for the taxable year or for any of the three preceding taxable years, subject to certain limitations.

The portion of the gains, profits, and income of the nonresident alien individual or nonresident foreign entity purchaser that is treated as Puerto Rico source income, when the above requirements are satisfied, is determined by multiplying the total income of the purchaser by a fraction, the numerator of which is the sum of four equal factors: property, payroll, sales and purchases, and the denominator of which is four.

Excise tax

Notwithstanding the abovementioned, in lieu of taxation of the income of a nonresident alien individual or nonresident foreign entity meeting the above 10% source of income tests, an excise tax will be imposed on such nonresident alien individual or nonresident foreign entities that acquire personal property and services from related sellers whose gross receipts exceed \$75,000,000 for any of the three preceding taxable years.

The excise tax rate will be 4% for purchases made during the calendar year 2011, with succeeding reductions to 3.75%, 2.75%, 2.5%, 2.25%, and 1% in subsequent calendar years. For calendar year 2017, the excise tax will no longer be in effect, being subject to the source of income rule thereafter. Nevertheless, the rate in effect has remained at 4% for all years until further assessment is made.

Certain credits are available for controlled groups in order to reduce the excise tax. Moreover, the excise tax paid may be claimed as a foreign tax credit for federal income tax purposes.

The tax is imposed on the person acquiring such personal property and services but collected by the seller of the property or services and deposited with the Secretary of the Treasury by electronic means on or before the 15th day of the month following the month in which the purchase occurs with the corresponding payment voucher.

Each collector of the excise tax is required to file, for each quarter of a calendar year, a quarterly tax return on April 30, July 31, October 31, and January 31, and pay with the return that part of the tax that has not been paid or deposited with the monthly payment voucher.

Branch profit tax

Income taxation of a United States branch is the same as for a United States subsidiary. The only difference will be that a deemed dividend distribution tax (known as the 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.

A foreign corporation is not subject to the branch profit tax in a taxable year if for the current and two preceding taxable years at least 80% of its gross income was effectively connected with a Puerto Rico trade or business.

In determining taxable income, the branch will take into consideration items of income effectively connected with the conduct of a trade or business in Puerto Rico. The branch will be allowed to deduct the expenses directly allocable to the Puerto Rico business. In addition, a reasonable apportionment of expenses not directly related to any item of income shall be

allowed as a deduction. As for foreign subsidiaries, for years commencing after December 31, 2012, certain limitations to these deductions have been enacted.

Other reporting requirements

As a general rule, informative returns are to be filed for any payment of dividends or any payment in excess of \$500 for interest, rents, salaries, wages or services not otherwise reported, premiums, annuities, compensations, remuneration, or other fixed or determinable gains, profits, and income. Any person who credits or makes payments to a person of \$500 or more and who becomes obligated to withhold the tax on such payments shall file an informative return specifying the total amount paid or credited, the tax deducted and withheld, the name, address and the account number of the person to whom the payment or withholding was made. Said return shall be filed on or before February 28, of the year following the calendar year in which the interest was paid. For taxable years beginning after December 31, 2018, if a taxpayer wishes to deduct payments made for amounts less than \$500, an informative return must be prepared and filed with the Department of Treasury.

Municipal 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 nonfinancial businesses. For financial business, the tax rate ranges from 1% to 1.50%. This tax is paid directly to the municipality.

A number of business activities and types of income are exempt from municipal license taxes. For example, businesses operated by or for the government, businesses with a volume of business of less than \$5,000, income from the sale of agricultural products to farmers, tax-exempt not-for-profit organizations, international banking entities and insurance companies, the exporting activities of businesses operating in a tax-free zone, income from services performed as an employee, income from the sale of oil and its derivatives to the Puerto Rico Electric Power Authority, and plants engaged in the processing of tuna (provided they employ 300 or more individuals in the same physical facility) are 100% exempt from municipal license taxes.

The municipal license tax annual return or declaration must be filed every year 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 the declaration's due date, a 5% discount will be applied. A 6-month extension to file is available.

Audited financial statements certified by a CPA licensed in Puerto Rico must be attached to the declarations, if the total volume of business is equal to or exceeds \$3,000,000. Otherwise a copy of the income tax return may be required to accompany the declaration.

After the payment of the first installment, the municipality will issue a municipal license that must be posted in a clearly visible place in the business or service establishment.

Property taxes

Municipalities may impose, by means of municipal ordinances, a property tax of up to 10.33% per annum on the appraised value of all taxable personal property in the municipality and up to 12.33% per annum on the appraised value of all taxable real property in the municipality.

Real and personal property taxes are imposed as of January 1 of each year. Therefore, persons that did not own property as of said date are not subject to the property tax. Likewise, if property was owned as of January 1, but it was subsequently sold during the course of that year, the owner of the property as of January 1 is liable for the payment of the corresponding property tax for that year.

Municipalities do not have jurisdiction to impose property taxes on property located outside Puerto Rico. Also, property in interstate or foreign commerce is not subject to the Puerto Rico property tax. On the other hand, a property tax may be imposed on property located in Puerto Rico prior to being transported in interstate commerce or after the property finally comes to rest in Puerto Rico. If, on the assessment date, the property is under the control of the carrier and is to be shipped outside Puerto Rico, it is in interstate commerce and thus exempt from property tax. However, if the property had been sold to a buyer outside Puerto Rico but was still in the hands of the seller on the assessment date, the property tax liability for the property remains the responsibility of the seller, even if on the next day it is delivered to the carrier for shipment outside Puerto Rico.

Personal property tax

Any natural or juridical person engaged in trade or business in Puerto Rico, and that as of January 1 owns personal property used in said trade or business, must pay personal property tax to the municipality in which the property is located. The rates depend on the municipality and are imposed on the market value of the property. The market value is initially determined by the taxpayer. Generally, book value is accepted as equivalent to fair market value, but if book value does not reflect fair market value, the municipality may revalue the personal property.

Taxable property normally includes cash on hand, inventories, materials and supplies, furniture and fixtures, and machinery and equipment used in the trade or business. A minimum residual value is assigned to items which are substantially depreciated.

A personal property tax return must be filed on or before May 15 of each year in the corresponding regional office of the Municipal Revenue Collection Center or CRIM for its Spanish acronym, together with the full payment of such tax. A 3-month extension to file is available, although the tax must be paid by the due date.

If the volume of business [defined as gross receipts] of the entity exceeds \$3,000,000, the property tax return must be accompanied by audited financial statements certified by a CPA licensed in Puerto Rico. The financial statements of foreign corporations engaged in business in Puerto Rico should reflect solely their operations in Puerto Rico.

In the event that the corporation does not have a calendar year closing, a trial balance of its business activities in Puerto Rico as of the preceding January 1 will be required. The trial balance must be traced to the entity's accounting records and accompanied by a report from an accountant affirming that the trial balance is in agreement with the books of account of the business.

Real property tax

The real property tax is imposed on the value of the property as assessed by the CRIM. The tax is payable semi-annually on July 1 and January 1 of each year.

The assessed value is the valuation of property for property tax purposes, which is equal to the fair market value of the corresponding real property in the year 1958.

Excise taxes and other licenses

As a general rule, Puerto Rico imposes an excise tax on cigarettes, vehicles, alcoholic beverages, gasoline, oil and end products derived from oil, cement and certain plastic products imported to Puerto Rico. There is a different tax rate for each of the products mentioned above. Nonetheless, there are several exceptions to this general rule and some exemptions to the imposition of the tax.

Depending on the type of business you are proposing to start in Puerto Rico, you must be aware that you might be required to obtain certain licenses from the Puerto Rico Department of Treasury or other agencies [i.e. alcoholic beverage, cigarettes, financial institutions and air, land and sea carriers, among others].

Sales and use tax (SUT)

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, beginning on March 1, 2019, services rendered by merchants with volume of business not exceeding \$200,000 annually (previously was \$50,000) are exempt from both the 11.5% basic SUT (10.5% state portion plus 1% municipal portion) and the 4% special SUT.

Rates

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

- tangible personal property;
- taxable services;
- admission rights; and
- combined transactions.

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

- services rendered to other merchants; and
- designated professional services.

Starting on October 1, 2019, a new reduced SUT rate of 7% will apply to eligible restaurants selling taxable items such as prepared foods, carbonated beverages, confectionary products and candies. To qualify as an eligible restaurant the business must comply with the following requirements:

- the merchant registration certificate must have one of the following NAICS codes;
 - 72231 - Food Service Contractors
 - 72232 - Caterers
 - 72233 - Mobile Food Services
 - 72241 - Drinking Places (Alcoholic Beverages)

- 72251 - Restaurants and Other Eating Places
- must be current with the filing of monthly SUT returns and Declarations;
- the merchant should not have any tax debts for any concept with the Department of Treasury; and
- the merchant must comply with the requirement to install, possess and maintain, at each point of sale in the commercial localities, a fiscal terminal despite the exception to the requirement for those merchants whose annual aggregate sales does not exceed \$125,000.

The Puerto Rico Code also provides several exclusions and exemptions from the SUT, which will vary depending on the taxable item purchased or the person who purchases the item.

Semi-monthly sales tax deposits

Act No. 46 of 2017, requires the following persons to remit the sales tax in semi-monthly installments: (i) large taxpayers and (ii) those merchants with monthly sales tax deposits for the prior year in excess of \$2,000. For purposes of the \$2,000 criteria, the term “deposited” refers to the sum of the SUT deposited on the import and purchase of inventory for resale and the SUT deposited on sales made by the merchant.

The deadlines for making the semi-monthly sales tax deposits are:

- first installment – the 15th day of each month; and
- second installment – the last day of the month.

Merchants subject to make the semi-monthly sales tax deposits will comply with the deposit obligation if the sum of the two semi-monthly installments deposited with the Department of Treasury during the month, is at least any of the following amounts:

- 80% of the SUT determined for current month; or
- 70% of the SUT remitted during the same month of the preceding year.

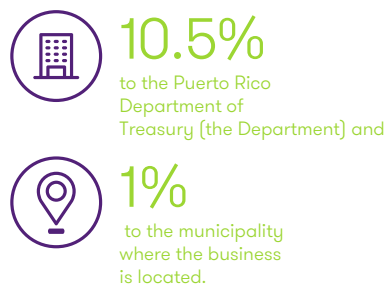
Exemption certificates

Every registered merchant, who is a reseller may request a Reseller and Municipal SUT Exemption Certificate through the Unified System of Internal Revenue or SURI for its Spanish acronym. In order to qualify for the Reseller and Municipal Exemption Certificate, during the period of 3-taxable years immediately preceding the year for which it is wanted to determine whether the merchant is a reseller or not, an average of 80% or more of its inventory must have been removed for resale (not including the sales of services or the sale of exempt items).

This certificate will allow the reseller to claim a credit for the SUT paid upon purchases of tangible property for resale up to 100% of the amount to be deposited with the SUT monthly return. Also, it allows its suppliers to collect only 10.5% on those purchases.

The Puerto Rico Code provides an exemption from the SUT to manufacturing plants in the acquisition of raw material, as well as machinery and equipment to be used in the manufacturing process. To claim this exemption, the merchant has to request the Exemption Certificate for Manufacturing Plants through SURI.

If substantially all sales are made to exempt persons (i.e. government, manufacturers, etc.) or for exportation, the reseller may request an Eligible Reseller Certificate through SURI. This certificate will provide exemption to the reseller on the payment of SUT upon eligible purchases.





Tax incentives

Tax incentives

There are several laws that provide tax incentives to local and foreign qualifying business activities that establish operations in Puerto Rico. On July 1, 2019, the government of Puerto Rico enacted Act No. 60, known as the Puerto Rico Incentives Code, which compiles all current and outstanding tax incentives laws into a single code.

Qualifying industries such as scientific research and development, manufacturing operations, export services, financial and insurance services, recycling businesses, technology, film, agriculture, hospital facilities, hotels and related tourist activities are eligible for full or partial exemption from income, property, municipal and other taxes. The Puerto Rico Department of Economic Development and Commerce or DDEC for its Spanish acronym, is the primary government institution tasked with promoting industry and foreign direct investment in Puerto Rico.

Incentives

The following is a list of the most important incentives currently in force in Puerto Rico:

Puerto Rico's tax incentives

- Small and medium businesses (PYMES)
- Individuals
- Exportation of goods or services
- International financial entities (IFEs)
- International insurers and reinsurers
- Public-private partnerships
- Private equity funds
- Tourism
- Cruise-ship industry
- Manufacturing
- Renewable energy
- Agroindustrial activities
- Film and creative industries
- Entrepreneurship
- Foreign trade zones
- Priority Projects for qualified opportunity zones (OZs)

Overview

Aiming to codify incentives granted for diverse purposes throughout decades in one code and foster economic development more effectively, Act 60 establishes a Return on Investment (ROI) methodology as a measurement tool to grant tax incentive benefits.

Although the effective date of Act 60 is July 1, 2019, the government of Puerto Rico established a transition period of 6 months, ending on December 31, 2019, allowing taxpayers to file for tax incentive benefits under prior tax incentives laws, provided they were not completely repealed by Act 60. Therefore, starting on January 1, 2020, all tax incentives applications shall be submitted under Act 60. For simplification purposes, we will focus the discussion of incentives under Act 60. However, note that incentives granted under previous laws are subject to the provisions of the law under which the tax exemption grant was issued.

Act 60 adopts a legal and administrative framework for the application, evaluation, and grant or denial of incentive benefits by the government of Puerto Rico. The following are some standard terms and incentives provided by Act 60 to exempt businesses:

- 4% fixed income tax rate on eligible income;
- 75% exemption on property taxes;
- 50% exemption on municipal taxes;
- tax exemption grant ("Grant") period standardized to 15 years, with an extension of 15 additional years;
- eligible businesses with an annual projected or actual volume of business of more than \$3 million shall maintain at least 1 employee if it's a grantee of export services, and 3 employees for manufacturing services; and
- research and development tax credits.

Small and medium businesses (PYMES)

PYMES (for its Spanish acronym) play a significant role in the economy of Puerto Rico and the Government is focused on facilitating their growth. Two governmental institutions are particularly focused on PYMES: the Economic Development Bank and the Puerto Rico Trade and Export Company.

Under Act 60, PYMES are defined as an eligible business with average gross receipts of \$3 million or less during the previous 3 years and are subject to additional benefits during the first 5 years of operations. If an eligible business classifies as a PYME, it will enjoy the following incentives during the first 5 years of operations:

- 2% fixed income tax rate on eligible income;
- 100% exemption on property taxes;
- 100% exemption on municipal taxes; and up to 30% tax credits on purchases of manufactured products in Puerto Rico.

Eligible businesses in Vieques and Culebra

Eligible businesses operating in the municipalities of Vieques and Culebra enjoy the following incentives during the first 5 years of operations:

- 2% fixed income tax rate on eligible income;
- 100% exemption on property taxes;
- 100% exemption on municipal taxes; and
- up to 30% nontransferable tax credits on purchases of manufactured products in Puerto Rico.

Strategic projects

Companies promoted by the DDEC that execute projects deemed to have extraordinary importance for the economy of Puerto Rico (i.e. because they create and maintain a large number of jobs or a lesser number of high-quality jobs, promote new technology, transfer technology business knowledge, or are otherwise considered highly meritorious by the executive director and the board of the DDEC), may be eligible for incentives.

New pioneer activities

New pioneer activities mean business activities not previously performed in Puerto Rico within a 12-month period by an eligible business filing an application for a Grant, and that possesses special attributes, characteristics or qualities for the socioeconomic development of Puerto Rico.

If an eligible business is designated as a new pioneer activity, it shall enjoy a 4% fixed income tax rate on eligible income, that could be lowered down to 1%, at the discretion of the Secretary

of the DDEC in consultation with the Secretary of Treasury.

Tax incentives for individuals

Resident individual investors (previously Act 22-2012)

Seeks to attract new residents to the island by providing a total exemption from Puerto Rico's income tax on all passive income realized or accrued after the individual becomes a bona fide resident of Puerto Rico.

Under Act 22, the tax incentives applied to any individual investor that became a Puerto Rico resident on or before the taxable year ending on December 31, 2035, provided the individual was not a resident of Puerto Rico at any time during the 6-year period preceding January 17, 2012.

Under Act 60, the residency test of December 31, 2035 remained unchanged, although the individual investor shall not have been a resident of Puerto Rico at any time during the 10-year period preceding July 1, 2019.

Some of the tax incentives for individual investors are:

- 100% exemption from Puerto Rico income taxes on interest and dividend income derived during the tax exemption period;
- 100% exemption from Puerto Rico income taxes for capital gains derived by resident individual investor for appreciation of securities accrued after becoming a Puerto Rico resident, if such gain is recognized prior to January 1, 2036; securities held prior to the move are subject to regular capital gains rates if disposed within 10 years from the date of the move; or 5% if sold after 10 years but before 2035; and
- Grant expires on December 31, 2035.

As requisite for the granting of these benefits, the individual investor must provide evidence of a personal or commercial bank account in a financial institution or credit union with presence in Puerto Rico. If the individual investor has not moved to Puerto Rico, he or she may submit the evidence as soon as he or she resides in Puerto Rico.

Furthermore, under Act 60, the individual investor must acquire residential property from an unrelated person, within 2 years after the effectiveness of the Grant, and shall make annual contributions of at least \$10,000 to not-for-profit organizations operating in Puerto Rico duly certified as such by the Puerto Rico Department of Treasury.

Qualified physicians (previously Act 14-2017)

Every individual admitted to the medical or podiatry practices, or that is a dental surgeon or practices any odontology specialty, is considered a qualified physician and may request the tax incentives under Act 60, subject to the limitations discussed below.

A qualified physician that is a bona fide resident of Puerto Rico, may request the tax incentives on or before September 30, 2019; provided a dental surgeon that is a bona fide resident of Puerto Rico shall request the benefits on or before June 30, 2020. Meanwhile, a qualified physician that is not bona fide resident of Puerto Rico, shall request the benefits on or before June 30, 2020.

Qualified physicians are exempt from the required annual contributions of at least \$10,000 to not-for-profit organizations operating in Puerto Rico duly certified as such by the Puerto Rico Department of Treasury; shall enjoy a 4% fixed income tax rate on eligible income and; 100% exemption on eligible dividends distributions from eligible medical service entities up to \$250,000 per taxable year.

Professionals of difficult recruitment

Although the term is yet to be further defined by the DDEC by means of regulations, the eligible individual must be a full-time employee whose specialized knowledge is indispensable to an eligible business. If said requirement is met, the eligible individual is able to request a Grant. Incentives include salaries derived in excess of \$100,000 are exempt from Puerto Rico income taxes, including alternative basic tax; provided the first \$100,000 of salaries earned are subject to the regular tax rates stated in the Puerto Rico Code.

The eligible individual is exempt from the required annual contributions of at least \$10,000 to not-for-profit organizations operating in Puerto Rico duly certified as such by the Puerto Rico Department of Treasury.

Researchers or scientists

An eligible researcher or scientist contracted by the University of Puerto Rico, or any other institution of superior education authorized to operate in Puerto Rico and engaged in eligible scientific research, subject to certain requirements and certifications, is eligible for a Grant providing an income tax exemption not to exceed \$195,000 of the salaries received.

Moreover, an eligible researcher or scientist contracted to provide scientific and technology research and development services within the district set forth on Article 7 of Act No. 214 of 2004, known as the Act to Create the Puerto Rico Science, Technology and Research Trust, is eligible for an income tax exemption not to exceed \$250,000 of salaries received.

An eligible researcher or scientist that requests a Grant under the provisions herein included, must render at least 60 hours of community service per year, pursuant to the requirements included in the Grant.

Senior individuals

Act 60 adopts a public policy to promote and develop the full potential of the senior population, through education and training, for them to reincorporate to the workforce or become entrepreneurs and contribute to the economic development of Puerto Rico.

Qualified promoters

Act 60 adopts incentives for qualified promoters that render promotions services to new businesses under a Grant. Promoters enjoy an incentive of up to 50% of the income tax paid by the exempt business that enters the Economic Incentives Fund and is transferred to Invest Puerto Rico Inc., for a period of up to 10 years since the date of establishment of the new business in Puerto Rico. An individual may qualify for the incentives if they comply with the following requirements:

- be the owner, stockholder, member or employee full-time of an eligible business with a Grant for promotion services;
- possess a bachelor's degree from an accredited university;
- have at least five years of professional experience in their field;
- have the ability to understand and adequately express matters related to the establishment of new businesses in Puerto Rico; and
- file a sworn application with the DDEC, among other requirements.

The qualified promoter cannot claim the tax incentives for new businesses which he or she owns or is a stockholder or member of, or their spouse, parents or children are in a managerial role involving decision making.

Tax incentives for the export of goods and services (previously Act 20-2012)

The tax incentives endeavor to turn Puerto Rico into an international hub of export services, retain local talent, attract foreign talent and foreign capital, and create a special fund for promoting the establishment of new businesses to export services from Puerto Rico.

Act 60 offers a number of incentives to businesses engaged in eligible services in Puerto Rico. The term eligible service includes, but is not limited to:

- research and development;
- advertising and public relations;
- economic, environmental, technology, scientific, managerial, marketing, human resources, information systems, engineering, auditing, and other consulting services;
- advising and consulting on matters related to any industry or business;
- creative industries, including the sale of tickets outside of Puerto Rico or the purchase of said tickets by tourists in Puerto Rico, as well as revenues related to the transmission or the sale of recording rights for audiences outside of Puerto Rico, of shows, musical productions, eSports and fantasy leagues events taking place in Puerto Rico;
- production of engineering and architectural blueprints and designs;
- advanced professional services such as legal, tax and accounting services;
- shared services centers;
- investment banking and other financial services;
- commercial distribution of products manufactured in Puerto Rico to outside markets;
- assembly, bottling and packaging of products for markets outside of Puerto Rico;
- distribution in physical form, network, cloud computing or blockchain and income derived from subscriptions, licensing or fees;
- international trading companies; and
- many other services included within Act 60, as well any other service designated by the Secretary of the DDEC.

In addition to the 4% fixed income tax rate, and property and municipal exemptions, the export of goods and services enjoy:

- 100% exemption on dividends or profit distributions; and
- 100% exemption from property taxes on call centers, corporate headquarters and distribution centers, for the first 5 years of operations.

Tax incentives for international financial and insurance entities

International financial entities (previously Act 273-2012)

Provides tax incentives to international financial entities (“IFE”) that set up operations in Puerto Rico. Act 60 aims to improve the conditions for conducting international financial transactions in Puerto Rico, while simultaneously boosting the island’s economy.

A licensed IFE can request a Grant which will enumerate and secure the standardized incentives of Act 60 (4% fixed income tax rate, and property and municipal exemptions) for a 15-year period. Additionally, the Grant provides a 6% income tax rate on distributions to shareholders or members resident of Puerto Rico and 100% exemption on distributions to nonresident shareholders or members of Puerto Rico.

Like other incentives in Puerto Rico, the IFE tax incentives can interplay with incentives for individual investors, so that dividends received are fully exempt from Puerto Rico income taxes. Dividends paid would also be excluded from United States income taxes to the extent they are Puerto Rico source income pursuant to the source of income rules of the United States Code and the recipient of the dividend is a bona fide resident of Puerto Rico.

International insurer and reinsurer (previously Act 399-2004)

Provides for the establishment of international insurers, branches of international insurers, international reinsurers and holding companies in Puerto Rico to convert the island into an ideal domicile for international insurers. Protected cell plans and securitization plans are allowed.

To qualify as an international insurer or reinsurer, an insurance company must be licensed and regulated by the Puerto Rico Insurance Commissioner. Generally, an international insurer is one that provides direct insurance only for risks outside of Puerto Rico, although it can provide surplus line coverage and reinsurance for risks located in Puerto Rico. One of the competitive planning opportunities as a foreign jurisdiction for

advantages of Puerto Rico, is that it provides tax planning opportunities as a foreign jurisdiction for United States income tax purposes, while also being a regulated and accredited member of the National Association of Insurance Commissioners (NAIC), the United States Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC).

International insurers, branches, and international holding companies are given attractive tax treatment under Act 60:

| Tax | Tax Rate |
|---|---|
| Income tax | 4% fixed income tax rate on the excess of \$1.2 million |
| Branch profit tax | 100% exemption |
| Dividends, other distributions of profits or distributions in liquidation | 100% exemption |
| Municipal license tax | 50% exemption |
| Property tax | 75% exemption |

In addition, they are not required to file tax returns, and the revenues to nonresidents are also exempt from taxation.

Tax incentives for private equity funds (previously Act 185-2014)

Seeks to provide Puerto Rico businesses that have limited or no access to public capital markets the opportunity to receive equity capital to promote economic development in Puerto Rico.

Any partnership or limited liability company organized under the laws of Puerto Rico, the United States or any other foreign jurisdiction that invests in different securities issued by entities that, at the time of acquisition, are not publicly traded, qualify as a Puerto Rico private equity fund ("PRPEF") or a private equity fund ("PEF").

If the PEF complies with various requirements, it will benefit from a total exemption on interest, dividends and capital gains, as well as municipal license taxes, and a 75% exemption on property taxes.

Resident investors that invest in a PEF may deduct from taxable income up to a maximum of 30% of their "initial investment" within a period of 10 years, provided that the maximum deduction shall not exceed 15% of their net income prior to such

deduction. If the investment is made into a PRPEF, the deduction shall be 60% of their "initial investment" within a maximum period of 15 years, and with a maximum deduction that does not exceed 30% of their net income prior to such deduction. The deduction may be claimed for the taxable year that precedes the taxable year in which the "initial investment" is made, if it is made prior to the due date for filing the income tax return for such prior taxable year.

In the case of the PEF's accredited investors, they are subject to a fixed 10% tax rate on interest and dividend income, while Puerto Rico sourced capital gains will be tax-exempt. In addition, the sale of ownership interest is subject to a fixed tax rate of 5%, unless the proceeds are reinvested within 90 days in a PRPEF. Net capital losses derived from investments made in companies that derive at least 80% of its gross income from Puerto Rico sources may be claimed as a deduction.

For general partners and registered investment advisors, interest and dividend income is subject to a fixed tax rate of 5%, and capital gains to a 2.5%.

Tax incentives for hotel and hospitality services

The Puerto Rico tax incentives package offers hotel developers a competitive advantage over developing in other destinations. The incentives aim to facilitate the establishment of tourism-development projects throughout Puerto Rico.

Tourism development of Puerto Rico (previously Act 74-2010)

Bestows a series of tax credits and incentives to both new and existing tourism businesses that are deemed eligible.

An existing business is one that, at the time of requesting the Grant, is operating a tourism activity and will undertake a substantial expansion or renovation of the existing physical facilities used on the tourism activity.

A new business is defined as one that, at the filing date, will utilize facilities that:

- have not been used for tourism activities during the previous three years prior to said filing date;
- have not been used for tourism activities during the previous 18 months prior to the filing date, and the executive director of the Puerto Rico Tourism Company waives the aforesaid 3-year requirement; or

- irrespective of the above referenced terms, any existing business or property that is subject to an expansion and/or renovation which exceeds 100% of its acquisition cost or fair market value at conveyance, and said investment is completed within 36 months after said acquisition or conveyance.

The following business activities qualify as tourism-related activities:

- ownership or administration of:
 - hotels, condo-hotels, timeshares/vacation clubs, hostels, guesthouses, bed & breakfasts, and inns under the “Posadas de Puerto Rico” program;
 - theme parks, golf courses, marinas for tourism purposes, port facilities in areas that promote tourism activities;
 - natural resources as a source of entertainment value, and;
 - other entertainment or recreational tourism-related facilities.
- leasing or rental of property to an exempt business dedicated to tourism-related activities.

Tax credits

Any person who acquires an equity interest in a corporation or partnership that develops an eligible business, is entitled to choose between two options for the investment tax credit. Under the first option, the credit is equal to 40% of the eligible investment made in the tourism project and can be taken in three equal installments, commencing on the exempt tourism activity’s second year of operations. The second option provides a credit equal to 30% of the eligible investment made in the tourism project. Nonetheless, only 10% of the credit can be claimed in the year the tourism activity secured the financing for the development of the tourism project, with the remaining balance available in three equal installments:

- 1/3 when the exempt tourism activity receives its first paying guest; and
- the remaining 2/3 on subsequent years, in equal 1/3 portions.

Since the tax credits may be assigned, transferred or sold, developers typically sell the tax credits in the local Puerto Rico capital market and invest the proceeds into the project. In essence, the tax credit lowers the amount of equity the developer has to come up with as part of the project’s capital structure.

Promotion and development of the cruise-line industry (known as Act 133-2011)

The cruise industry in one of Puerto Rico’s main tourism and economic sectors, not only for its economic impact, but also because of the role it plays in promoting the island’s image in the world. Puerto Rico is, in turn, a top-tier destination for the cruise industry.

The incentives strengthen Puerto Rico’s competitiveness in the cruise industry, including such key segments within the industry as the supply chain, service providers and cruise-lines. The law provides a string of incentives to promote transit and homeport cruise visits, spur travel agencies to sell packages to nonresidents that include both a cruise and a stay in a hotel in Puerto Rico; the purchase of products in Puerto Rico; the local procurements of ship maintenance and repair services; and the promotion of excursions for cruise-ship passengers. The benefits simplify the industry’s dealings with the government making the process of obtaining incentives more efficient, transparent and simple.

Act 60 provides cruise-ships a reimbursement system of 10% for food and beverage purchases or engaging maintenance and repair services in Puerto Rico while docked at any Puerto Rico port. An additional 5% is granted for purchases of products manufactured in Puerto Rico, duly certified by the Puerto Rico Industrial Development Company, or agricultural products of Puerto Rico, duly certified by the Puerto Rico Department of Agriculture, while docked at any Puerto Rico port.

Tax incentives for manufacturing (previously Act 73-2008)

Promotes businesses established to manufacture products, engage in a wide range of specific economic activities, such as scientific research and development, recycling, hydroponics, value-added activities pertaining to port operations, software development, manufacturing of renewable energy equipment, and aerospace industry research and development.

The tax incentives operate through the issuance of a Grant that lasts for a period of 15 years. The Grant identifies and guarantees the incentives to which the eligible business is entitled. To obtain a Grant, an eligible business must submit an application, with all required supporting documents and fees.

Key provisions

The incentives make industry operations in Puerto Rico highly profitable while stimulating additional economic development. These include:

- 4% or 8% fixed income tax rate;
- 12% fixed income tax rate on royalty payments;
- 75% exemption on property taxes; and
- 50% exemption on municipal taxes, among other benefits.

Special incentives

Other special incentives have been created to encourage the establishment and retention of local and foreign investment in Puerto Rico. Incentives may vary as a result of the adoption of Act 60 and the regulations that have yet to be issued, but traditional incentives include:

- job creation incentives;
- location incentives;
- special aid for the rescue of a project;
- incentive for infrastructure development and industrial building improvements;
- incentive for the Puerto Rican industry manufacturing of furniture and related products, and the apparel industry and similar products; and
- marketing incentives program.

Tax incentives for renewable energy (previously Act 83-2010)

Puerto Rico has entered a new age in terms of its diversification of energy sources with the implementation of a new public energy policy and programs to diversify energy sources, ensuring that the generation of electricity on the island is affordable, viable and sustainable.

The incentives provide benefits for companies dedicated to the production of renewable energy on a commercial scale, in addition to the standardized benefits mentioned above (i.e. 4% fixed income tax rate and municipal and property tax exemptions):

- 100% exemption from sales and use taxes and excise on certain items used in connection with the green energy project, including natural and propane gas used for the generation of electric or thermal energy;
- 75% exemption from any tax, law, license, excise tax, rate or fee levied by municipal ordinance on the construction of works related to the green energy project; and
- 100% exemption from income taxes for dividends paid from income derived for renewable energy activities.

An eligible business totally disconnected from the electric system of the Puerto Rico Electric Power Authority or “PREPA” for its acronym, is not required to sell the energy produced to PREPA to receive or keep the Grant.

The types of energy considered alternative or sustainable renewable energy under Act 60 are:

- landfill gas combustion;
- anaerobic digestion;
- fuel cells;
- waste heat;
- solar energy;
- eolic energy;
- geothermal energy;
- renewable biomass combustion;
- renewable biomass gas combustion;
- combustion of biofuels derived from renewable biomass;
- qualified hydropower;
- marine and hydrokinetic energy; and
- ocean thermal energy.

Tax incentives for the agroindustrial activities

Puerto Rico provides incentives to promote the sustainable growth of the island’s agricultural sector.

Agriculture (previously Act 225-2005)

Provide incentives to bona fide farmers and agricultural businesses. To qualify as a bona fide farmer or agricultural business, the applicant must:

- derive 51% or more of the gross income from an agricultural business as an operator, owner or tenant as recorded in the corresponding income tax return; or
- derive 51% of the production value and/or investment of an agroindustry business as an operator, owner or tenant.

Farming, animal breeding, agroindustrial operations and other agriculture related operations are eligible for 90% income tax exemption and full exemption from property, excise and municipal taxes. Special tax credits are available for certain investments in eligible agricultural operations.

Bona fide farmers qualify for the following tax benefits:

| Tax | Exemption |
|---|-----------|
| Agricultural equipment | 100% |
| Property taxes on land, equipment, fixtures, and vehicles owned, leased or usufruct, which are used intensively in the agricultural business | 100% |
| Municipal taxes on intensive agricultural activity | 100% |
| Exemption on stamp payments to Puerto Rico's Department of Treasury and fees to register property used in the agricultural business | 100% |
| Tax income on earnings that derive directly from the agricultural business, if the farmer has not already benefited from the provisions established in Sec. 8423(s) of the Puerto Rico Code | 90% |
| Tax credit for investment in eligible | 50% |

Act 60 also provides the following benefits:

- an annual bonus for agricultural workers between of \$165 or 4% of the annual salary of the employee, whichever is greater, up to \$235 (previously Act 42-1971); and
- a wage subsidy program for eligible farmers (previously Act 46-1989).

Tax incentives for the film industry and creative services

Puerto Rico's film industry has two pillars: the island as a film destination and that actual films produced locally. Film incentives have made the island an ideal location in which to shoot movies in the development and post-production stage.

Film industry incentives (previously Act 27-2011)

The benefits aim to bring Puerto Rico's production cost structure in line with other leading jurisdictions through innovative and competitive tax incentives. In recognition of the importance of complementing a low-cost structure with state-of-the-art, especially dedicated infrastructure, the benefits also provide for numerous incentives for the development and operation of related infrastructure, specifically high-capacity production studios.

Production incentives

Besides the standardized tax incentives mentioned above (4% fixed income tax rate and municipal and property tax exemptions), film industry services enjoy:

- 40% tax credit on all payments to Puerto Rico residents;
- 20% tax credit on all payments to nonresident talent (including stunt doubles). Payments made to nonresident talent are subject to a 20% withholding;
- up to 15% tax credit of Puerto Rico production expenses, excluding payments made to a foreign person, in full-lengths films, series or documentaries in which a domestic producer is in charge of the Film Project, and the director, cinematographer, editor, production designer, post-production supervisor or the line producer are domestic persons, up to a maximum of \$4 million of the tax credit per Film Project.
- qualifying projects:
 - feature films;
 - short films;
 - documentaries;
 - television programs;
 - episodic series;
 - mini-series;
 - music videos;
 - national and international commercials;
 - video games;
 - recorded live performances; and
 - original soundtrack recordings and dubbing.
- 75% exemption on municipal taxes, including municipal license taxes.

Tax incentives for entrepreneurship (previously Act 135-2014)

Aims to retain young talent in Puerto Rico and stimulate the return of those young professionals that have moved out of the island.

A "young individual" is defined as any resident of Puerto Rico between the ages of 16 and 26 at the end of the taxable year. Under the incentives, the first \$40,000 of earned income is exempt from income taxes.

Also, the DDEC shall establish a student loan refinancing plan at competitive rates not to exceed 6% in exchange for the applicant committing to live and work in Puerto Rico for at least 6 years or for the negotiated repayment term, whichever is longer.

Businesses of young entrepreneurs may be eligible for a 3-year total exemption from income, property and municipal license taxes on the first \$500,000 of gross income.

Tax incentives for business incubators (previously Act 95-2013)

Explore ways to stimulate the expansion of business incubators in Puerto Rico, by adopting the incentives set forth herein to strengthen entrepreneurship and seek the necessary training for the creation of sustainable businesses that generate new jobs. The funds provided for these benefits will come from the Economic Incentives Fund.

Tax incentives for foreign trade zones

Puerto Rico has the largest noncontiguous foreign trade zone system in the United States. The system allows companies to obtain significant financial savings, since raw material, components, and packaging can be transported tax-free throughout these zones and items shipped abroad after processing are exempt from United States taxes.

Benefits include:

- deferment of federal customs duties;
- deferment of Puerto Rico excise taxes;
- 100% exemption on municipal license taxes on exports outside of the United States;
- 100% exemption on tangible property and equipment used;
- 60% exemption on the value of the property that is designated intangible; and
- 100% exemption on exports from the zone and sub-zones.

Tax incentives for Priority Projects in qualified opportunity zones (previously Act 21-2019)

Adopted as part of the Tax Cuts and Jobs Act of 2017 (“TCJA”), the opportunity zones program (“OZ Regime”), was designed to attract private investment into economically distressed areas. United States Code §1400Z-1, paves the way for low-income communities to be designated as qualified opportunity zones (“OZs”). Meanwhile, §1400Z-2 offers federal income tax incentives to a taxpayer who invests capital gains in a business located within an OZ.

Approximately, 98% of Puerto Rico has been designated as an opportunity zone, which creates an attractive investment alternative for United States investors.

Puerto Rico OZ Regime

Initially included in Act No. 21 of May 14, 2019, known as the Puerto Rico Economic Development and Opportunity Zones Act of 2019 (“Act 21”), §6070.54 through §6070.69 of Act 60, incorporates almost identically the provisions of Act 21.

Act 60 states that it is the public policy of Puerto Rico to make the island an investment destination for qualified opportunity funds (“OZ Funds”) that invest in Priority Projects located in OZs.

The Puerto Rico OZ Regime intends to:

- amend §1031.06 of the Puerto Rico Code to adopt a section parallel to §1400Z-2 of the United States Code, regarding the special rules for capital gains invested in OZ Funds to allow for capital gains subject to Puerto Rico income tax to be taxed at preferential rates; and
- create a new incentives regime for Priority Projects located in OZs.

Act 60 adopts the OZ Priority Project Committee (“OZ Committee”) originally adopted by Act 21, composed of seven members: the Government’s Chief Financial and Chief Investment Officers, the Executive Directors of the Puerto Rico Fiscal Agency and Financial Advisory Authority and the Puerto Rico Public-Private Partnerships Authority, the Secretary of the DDEC, and two members chosen by the Legislative Branch (one by the Senate and one by the House).

Eligible investment

Means the cash contributed to:

- an OZ Fund in exchange for stock or partnership interest;
- an OZ Fund in exchange for stock or partnership interest, and the OZ Fund invests the contributions as capital in an eligible business in exchange for stock or partnership interest, and the investment is in OZ property; or
- an entity that is an eligible business in exchange for stock or partnership interest, as applicable, if an OZ Fund invests in such entity and the investment is in OZ property.

Eligible business

An eligible business is a business that meets the following requirements:

- the business activity is performed in its entirety in an eligible OZ;

- the business activity performed is not eligible for a Grant under prior tax incentives laws or any successor or analogous law;
- the business activity is performed by an OZ Fund or an entity that invests in OZ property; and
- the business activity performed is a Priority Project in an OZ.

Businesses in the export services, manufacturing, tourism, energy and film sectors are not precluded from benefitting from the special treatment of capital gains invested in an OZ Fund. Rather, they will not be able to benefit from the investment credit provided that those businesses may seek to obtain a Grant to cover their activities under the corresponding chapter of Act 60 according to the nature of such trade or business (i.e. export, manufacturing, etc.).

Priority Projects

A Priority Project is defined as a trade or business or other activity for the production of income that will contribute to the social and economic diversification, recovery or transformation of the community in the eligible OZ.

The OZ Committee published Resolution 2019-01 on August 19, 2019, to approve and adopt a list of the initial Priority Projects within OZs (“OZ List”). The OZ List shall be revised annually.

The Priority Projects included within the OZ List are considered eligible to apply for a Grant. If a proposed project is not on the OZ List, the proponent shall request the designation of the project as a Priority Project from the OZ Committee before filing an application for a Grant.

Commercial activity

Means any activity engaged in the primary purpose of making a profit. Commercial activity, including operating, investing and financial activities, are ongoing and focused on creating value for shareholders.

Commercial activity within the OZ List

The OZ List includes four eligible activities designated as Priority Projects for which a Grant may be requested:

- development of residential real property that is a Low-Income Housing Project, as defined in §42(g) of the United States Code, or by the Puerto Rico Department of Housing, for sale or rent;
- development of residential and/or commercial real property for sale or rent;
- development of industrial real property for sale or rent; or

- substantial improvement of an existing commercial property for sale or rent.

Priority Projects tax benefits

An approved Grant for Priority Projects within an OZ includes the following tax incentives:

- 18.5% fixed income tax rate on eligible business income;
- 18.5% withholding tax at source on rents, royalties, and license fees paid to entities not engaged in trade or business in Puerto Rico or to nonresident individuals;
- 100% exemption for dividend distributions;
- 100% exemption for interest income received on bonds, promissory notes or other obligations of an eligible business for the development, construction or rehabilitation of, or improvements to an eligible business;
- 25% exemption on property taxes (municipalities may provide an exemption up to 75% through municipal ordinance);
- 25% exemption on municipal license, excise and any other municipal taxes (municipalities may provide an exemption up to 75% through municipal ordinance);
- guaranteed 5% transferrable investment tax credit which may be increased to 25%;
- special permit process; and
- 15-year exemption period (flexible tax exemption is allowed).

Tax incentives for other economic development programs

Public-private partnerships

Puerto Rico has embraced public-private partnerships as a way to leverage the capital and expertise of the private sector with the management and oversight of the government to provide the public with needed assets and services. Several projects are underway. Please contact us should you be interested in obtaining more information.

The Economic Development Bank (BDE)

The BDE (for its Spanish acronym) offers financial support to PYMES through asset-based loans; participation loans with private financial institutions or under the Small Business Administration (SBA) 504 loan guarantee program; mezzanine financing or capitalization loans; tourism project loans; management buy-out loans; and credit lines for operational capital.

The Puerto Rico Trade and Export Company (CCE)

The CCE (for its Spanish acronym) is a public corporation under the DDEC's umbrella. CCE's mission is to foster the development of trade with special emphasis on PYMES, and the export of Puerto Rico products and services to other countries or regions.

Among the services it provides are the following:

- financing and consulting services;
- foreign trade and business development institute;
- voluntary chain program;
- commercial facilities;
- Puerto Rico exports;
- free trade zone 61; and
- Puerto Rico world trade center.



Expatriates

Expatriates

Expatriates taking up employment in Puerto Rico are subject to comprehensive tax and employment visa requirements. The United States (“U.S.”) immigration rules apply in Puerto Rico. Before visiting or working in the island, foreign nationals must obtain visas from a U.S. embassy or consulate.

Facts

Employment visas

Foreign nationals who want or need to work in Puerto Rico on a temporary basis (that is, they will not obtain permanent residence) must be certified by the U.S. Department of Labor. A petition from a local employer must generally be attached to the visa application. A person holding a temporary visitor’s visa cannot be employed by a Puerto Rico employer. Again, U.S. immigration rules apply in Puerto Rico.

Where the expatriate is a U.S. citizen, the above procedures are not required.

Tax returns and compliance

Personal tax returns should be filed by April 15 following the end of the tax year concerned. A 6-month automatic extension to file is available, extending the due date until October 15.

Even when the required income tax amount is withheld by the employer and deposited with the Department of Treasury, the taxpayer has the right to file an individual income tax return to claim applicable exemptions, deductions, and to pay tax according to the progressive tax tables applicable individuals.

For taxable years beginning after December 31, 2018, individual taxpayers (resident and nonresidents) are required to file an individual income tax return when they have gross income unless the tax was fully paid by withholding at source.

Tax year

Generally, Puerto Rico’s tax year for individuals runs from January 1 to December 31.

Tax rates for 2019

Pursuant to the Puerto Rico Code, the ordinary tax rates for: individuals (including married couples with prenuptial agreement with total separation of assets and married couples not living together), married filing jointly and married filing separately, are as follows:

| Taxable income (\$) | Percentage of exemption |
|---------------------|--|
| \$9,001 or less | 0% |
| \$9,001 - \$25,000 | 7% of the excess over \$9,000 |
| \$25,001 - \$41,500 | \$1,120 plus 14% of the excess over \$25,000 |
| \$41,501 - \$61,500 | \$3,430 plus 25% of the excess over \$41,500 |
| \$61,501 and over | \$8,430 plus 33% of the excess over \$61,500 |

There is a gradual adjustment of the lower tax rates, the personal exemption and credit for dependents, and for taxpayers whose net taxable income is over \$500,000. The Puerto Rico Code also provides for an alternate basic tax equivalent to the alternative minimum tax in the United States.

For taxable years beginning after December 31, 2018, the tax determined is 95% of the sum of the regular tax and the gradual adjustment.

Sample of income tax calculation for year ending on December 31, 2019:

| Taxable income | US\$ |
|---|------------------------|
| Employment income | 74,500 |
| Benefits provided (i.e. housing) | 28,200 |
| Gross income | 102,700 |
| Less: | |
| Qualified pension contributions (employees) | (10,000) |
| Overseas workdays (20% of gross income) | (20,540) |
| Personal allowance | (7,000) |
| Taxable income | 65,160 |
| | Tax bill* 9,156 |

*95% of the sum of the regular tax and the gradual adjustment.

Basis of taxation

Charge to tax

Puerto Rico residents are subject to income tax on their worldwide income. Conversely, nonresidents are subject to Puerto Rico tax on their Puerto Rico-source income only.

Residence

As mentioned above, the income subject to Puerto Rico income tax is determined based on the expatriate’s residence status.

Tax residence

Pursuant to the Puerto Rico Code, the term “resident individual” means a person who is domiciled in Puerto Rico. It is presumed that a person is a resident of Puerto Rico if they have been present in the island for a period of at least 183 days during the calendar year.

There are no current regulations issued under the Puerto Rico Code to clarify the definition of “resident individual”. Furthermore, there is no guidance as to whether an individual can become a resident of Puerto Rico immediately after moving into Puerto Rico, or whether an individual can have a domicile in Puerto Rico for only one year. Generally, if their intention regarding their stay is merely temporary and meets other requirements, even when they had been in Puerto Rico 183 days or more, they may not be considered bona fide residents of Puerto Rico.

There are various cases decided under the Puerto Rico Internal

Revenue Code of 1994, as amended, that provide guidance on this matter. In said cases, the Supreme Court of Puerto Rico determined that to qualify as a resident of Puerto Rico for income tax purposes, an individual must have:

- at least 1-year of residency in Puerto Rico (actual physical presence); and
- intent to reside in Puerto Rico for an indefinite amount of time.

For U.S. income tax purposes, the United States Code has its own rules to determine whether an expatriate is considered a bona fide resident of Puerto Rico. Namely, the United States Code states three requirements that must be met:

- comply with one of the five conditions for physical presence in Puerto Rico set forth in the Section 937 regulations, such as be present in Puerto Rico for at least 183 days during the taxable year (presence test);
- not have a tax home outside Puerto Rico during any part of the taxable year (tax home test); and
- not have a closer connection to the United States or a foreign country than to Puerto Rico during any part of the taxable year (closer connection test).

Determination of residency is essential, since a resident of Puerto Rico is taxed in the island on their worldwide income. A nonresident, however, is taxed only on their Puerto Rico source income, which in an expatriate’s case, would usually be the portion of their income earned for the services performed in Puerto Rico.

Income from employment

In the case of a nonresident, the tax is assessed on employment income derived from services performed in Puerto Rico. Some exceptions may apply depending on the amount of income generated in Puerto Rico, and the time spent in the island.

If the expatriate is considered a resident of Puerto Rico, all their income, no matter where earned or derived, is taxed in Puerto Rico.

Assessable employment income includes: wages, salaries, overtime pay, bonuses, gratuities, perquisites, benefits, among others, that constitutes compensation for services. There is also a requirement for the expatriate's employer to withhold Puerto Rico's income tax from the assessable employment income. The applicable tax rates depend on the expatriate's residence status.

In the case of a nonresident U.S. citizen of Puerto Rico, the required withholding is 20% of the Puerto Rico source income, while in the case of a nonresident alien, the required withholding is 29%.

Resident expatriates will have their tax withheld at source at the applicable tax rates (see applicable tax rates on the "Tax rates for 2019" section above).

Source of employment

As previously stated, when services are performed in Puerto Rico, the income is sourced to Puerto Rico and, thus, subject to Puerto Rico taxation for both residents and nonresidents. In the case of resident expatriates, all other worldwide income is also subject to Puerto Rico taxation.

Benefits (in kind)

In general, when the benefit is enjoyed in Puerto Rico, an income tax charge should arise. Therefore, housing, meal allowances, provision of car or relocation allowances, may be subject to Puerto Rico income tax. This taxation is in addition to the tax of the expatriate's salary if these are considered compensation and not reimbursement of expenses incurred while away from the expatriate's tax home.

Expatriate concessions

There are no expatriate concessions in Puerto Rico.

Relief for foreign taxes

In the case of resident expatriates, a foreign tax credit may be

claimed for taxes paid to any foreign country (including United States), on foreign income (including United States income) reported in Puerto Rico.

Deductions against income

Certain expenses can be provided by an employer tax-free when they qualify as wholly, exclusively and necessarily incurred in the performance of employment duties.

Residents of Puerto Rico are allowed certain deductions. Since Puerto Rico law cannot discriminate, nonresident U.S. citizens are allowed the same deductions determined using the proportion of their Puerto Rico income over their total income.

A nonresident alien is allowed only deductions directly related to the income generated in Puerto Rico. They would not be allowed any other deductions, personal or dependent exemptions.

The advantage of filing an income tax return for a nonresident alien performing services in Puerto Rico is that the individual would be considered as engaged in trade or business in Puerto Rico, and as such, able to use the graduated tax rates instead of being subject to a fixed 29% tax rate.

What taxes?

Capital gains tax

As of 2019, long-term capital gains are subject to a maximum rate of 15%. Short-term gains (one year or less) are subject to the regular income tax rates. An expatriate's exposure to income tax on capital gains is determined by their Puerto Rico tax residence status and source of capital gain.

Under the provisions of the Puerto Rico Code, capital gain source of income on the sale of personal property, in general, depends on the residence status of the taxpayer. Generally, capital gains tax is assessed on net gains after deducting the cost of acquisition of the asset from sale proceeds.

Inheritance, estate and gift taxes

Effective January 1, 2018, Puerto Rico repealed estate and gift taxes. A requirement for filing estate and gift tax returns depends on the expatriate's Puerto Rico tax residence and domicile position. Nonresident expatriates will be subject to reporting only upon the transfer of Puerto Rico property.

Investment income

The expatriate's tax residence status and source of income determine whether investment income such as interest, dividends, etc., is subject to Puerto Rico income tax.

Local taxes

There are no other local taxes for the expatriate to consider.

Real estate tax

Real estate tax rates fluctuate from 8.03% to 12.33%, depending on the municipality where the property is located.

Expatriates are affected only if they own real property located in Puerto Rico (i.e. a house in Puerto Rico).

Social security taxes

The U.S. social security contributions apply in Puerto Rico on the same basis and rates as in the Mainland. Please refer to these rules to determine how they may affect your assignments to Puerto Rico.

Stock options

Stock options may be qualified or nonqualified. The tax advantages of qualified stock options are generally the deferral of the imposition of the income tax on compensation and generating a capital gain later when the shares are disposed of after holding them for at least one year and a day.

Wealth tax

There is no wealth tax in Puerto Rico.

Other specific taxes

There are no other specific taxes related to expatriates in Puerto Rico.

Tax planning opportunities

Where a foreign assignment continues to exist and part of the expatriate's duties are performed outside of Puerto Rico, any employment income received with respect to the foreign duties remain not subject to Puerto Rico tax, provided the expatriate is not a resident of Puerto Rico.

Our tax team can help expatriates and their employers identify Puerto Rico's tax planning opportunities and review tax equalization policies, as well as providing compliance services regarding United States and Puerto Rico's tax filing requirements.

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